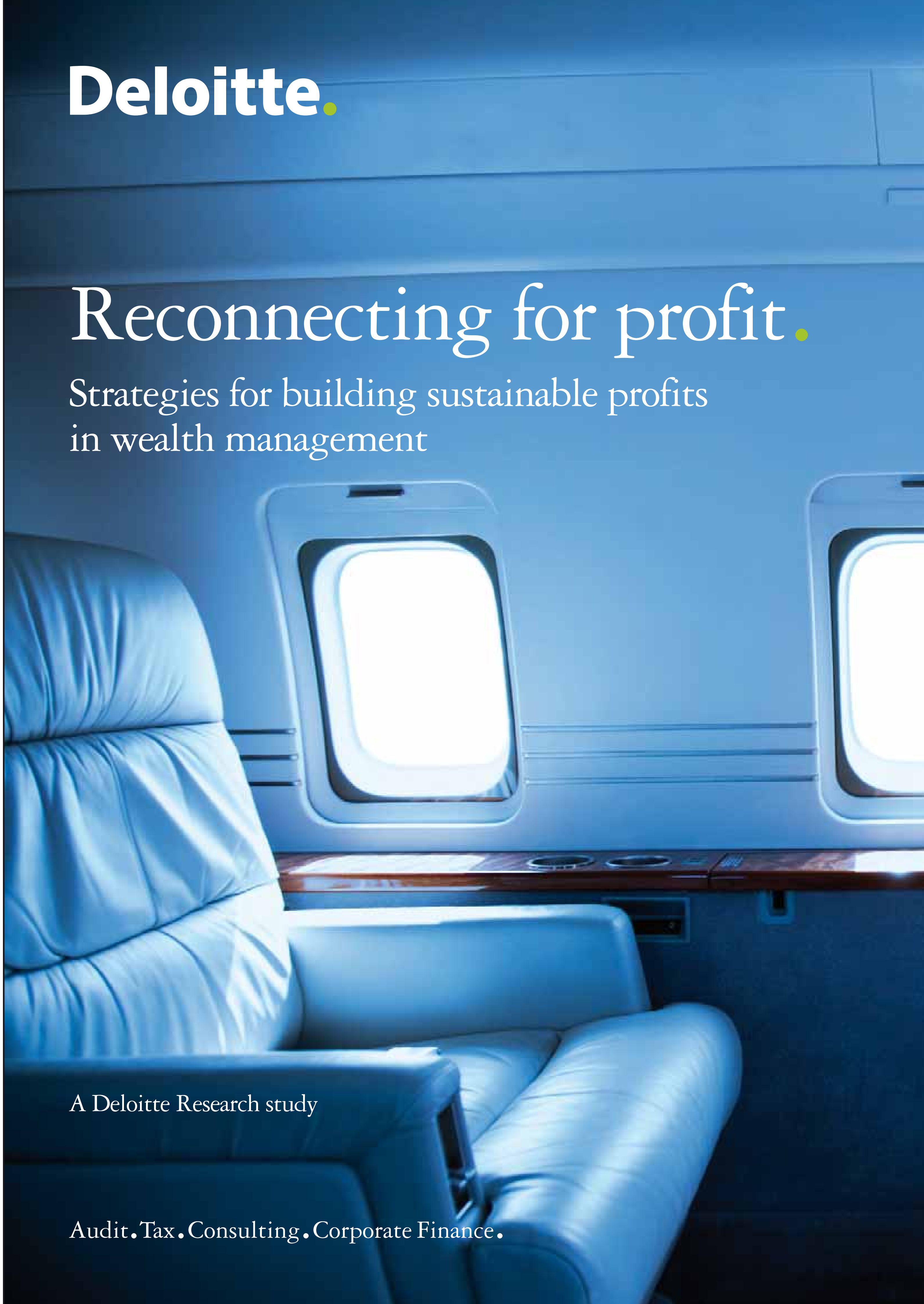

Deloitte.

Reconnecting for profit.

Strategies for building sustainable profits in wealth management

A Deloitte Research study

Audit. Tax. Consulting. Corporate Finance.

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About the research

This report summarises the results of a major qualitative study based on almost 50 in-depth discussions with private clients and leading wealth management executives. Our interviews with high net worth (HNW) private clients – defined here as individuals with total wealth of above $15 million (excluding primary residence) – revealed the ways in which clients use the wealth management market. This elite group collectively owns over half of all financial assets held by the HNW group.

This research primarily addresses European financial institutions with large or global private banking and wealth management operations. Our research sample includes senior executives from Europe's leading wealth management institutions. In addition to universal banks with wealth management arms, our research sample also included leading medium-sized wealth management and/or private banking institutions within the United Kingdom, Switzerland, Belgium and the Netherlands.

Foreword

The global private banking and wealth management market has enjoyed significant growth over recent years, riding a wave of high asset prices. Wealth managers have used this period to grow assets under management, extend the depth and breadth of products and services and expand into new client markets. With after-tax returns on equity averaging over 25 per cent in several major European markets, the sector remains the darling of a financial services industry in search of some good news amidst recent market turmoil.[1]

Despite the profitable performance, we ask in this report if wealth managers have used the growth period wisely. Have they sufficiently adapted their business models so that they can face the next five years confident of further growth? This report argues that forces are aligning that could test the resilience of wealth managers' business models. In particular, our research suggests that as wealth managers have pushed forward with their growth strategies, many private clients are feeling disconnected from them.

Focused on the high end of wealth management among European private banking and wealth management players, this report will be of wider interest for two reasons. First, ultra- and very-HNW individuals use a combination of large global providers, and small/medium-sized private banks and wealth management institutions. Second, high-end private clients share some common ground with less wealthy HNW individuals. Cutting across the traditional ultra-/very-HNW groups, we outline the trends among client segments on which fresh propositions can be built to reconnect with clients.

Russell Collins

Russell Collins
Co-leader, Deloitte EMEA Financial Services Industry


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Executive summary

Struggle for profit?

This report examines the high end of wealth management provision in Europe.[2] Individuals in the ultra- and very-HNW[3] segments represent approximately 50 per cent ($5.5 trillion) of the financial assets held by all HNW private clients in Europe.[4] Serving these elite groups is therefore important to wealth managers. There is evidence to suggest that growth in this market can, and will, continue. However, there are a number of challenges ahead that may cause wealth management institutions to struggle for profit.

A decline in asset prices; crises of confidence; operational limitations that restrict growth and service delivery; escalating costs, and suppressed client profitability all have the potential to drag down margins. Our discussions with private clients point to another major challenge: a significant portion of the client base is disconnected from, and lacks trust in, wealth management institutions. There is, in short, a 'trust deficit'.

Trust deficit

Private clients' trust deficit manifests in three ways. First, relationship managers (RMs) tend to be seen as 'product pushers'. Second, clients are often unsure if they are receiving objective advice or best-in-class products. Third, many private clients do not rate highly the investment expertise of their wealth managers. This lack of trust has a negative impact on wealth managers:

- It directly restricts profitability. High-end private clients often retain key decision-making, exhibit 'parts buying' behaviour and often appoint external advisors to 'manage their wealth managers'. Or they simply avoid the wealth management market as far as possible.

- It also represents a significant obstacle to growing high value services. Wealth managers are seeking to broaden their revenue platforms with more discretionary mandates and advisory fees by building businesses around the 'trusted advisor' model. A widening trust deficit and lack of connection with clients restricts wealth managers' ability to grow such revenue streams.

Reconnecting with clients

To reconnect with their high-end customer base, wealth managers should re-align their propositions so that they are driven by the factors most important to clients. Our discussions have identified three principles that typically influence the decisions of private clients:

- Diversification: on average private clients place just over a quarter of their wealth into the market, diversifying into a range of wealth management products as a safeguard against losses elsewhere. Clients also diversify by placing business with several wealth management institutions – using the services of approximately five wealth managers at any one time.

- Performance: many high-end private clients rate performance more highly than quality of service and banking relationships, expressing a need for more responsive wealth managers.

- Efficiency: private clients seek more efficient basic processes. While banks continue to broaden their range of products and services, their clients are more concerned that the existing repertoire is executed effectively.

Wealth managers should capture client insights based around these core principles. From this base, they can then identify client segments that enable them to tailor propositions for each client group. Going beyond marketing strategy, this segmentation approach may facilitate delivery against private clients' core needs. It may also improve wealth managers' ability to advance each client up the value chain towards improved profitability as propositions are tailored more closely to reflect the requirements of each segment.

Based on behavioural analysis, several segments emerged from our private client discussions, including: Finance Professionals, Entrepreneurs, Property Owners and Inherited Wealth. Building scalable propositions around each segment can give clients tailored services that more closely meet their needs.

Transformation agenda

To reconnect with clients it is important for wealth management institutions to reposition their offerings, aligning front and back offices more closely together. Our recommendations are:

- Client insight analysis – to provide the client insights necessary to underpin a successful transformation of the proposition.

- Segmentation strategy and client value management – to form the basis of scalable, tailored propositions and improved client profitability.

- Retool for efficiency and effectiveness – to bring simplified, robust basic processes and more effective services to multi-banked, high-end clients.

- Transform the service delivery/distribution model – to improve the clients' perception of front office expertise and facilitate teamwork to deliver the skills and experience of the organisation more effectively.

- Build a more integrated capability across banking functions – to bring a more coherent approach and accommodate clients with interests that often span different divisions.

Although many wealth managers are working towards some of these goals, the most successful wealth management institutions are likely to be those that take a co-ordinated and strategic approach to all these steps, to achieve transformation.

Struggle for profit?

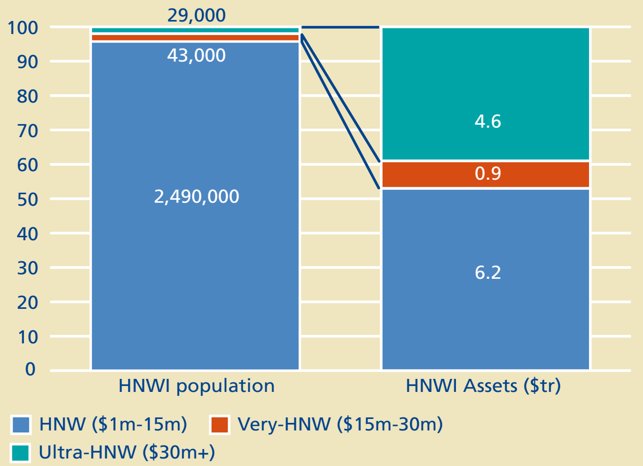
As the wealth management market has grown significantly over recent years, shareholder expectations have risen. There is evidence to suggest that growth in this market can, and will, continue. However, our research suggests there are also challenges ahead that are likely to affect wealth managers in their struggle for profit.

Defining the market

European wealth managers – as part of a universal bank or as an independent 'pure play' – have performed well over recent years. Total income among European market participants grew by an average of 14.1 per cent and 5.8 per cent in 2005 and 2006 respectively and 2007 is looking like a bumper year.[5] At the same time, European financial institutions suffered a 17.1 per cent drop in share prices in the year to March 2008.[6] Given the market turmoil dragging on certain financial sub-sectors, investors may look to wealth management and private banking operations for some relief from the bad news stories currently weighing on the financial services market.

This report examines the high end of wealth management provision, serving those in the ultra- and very-high net worth (HNW) individual segments. Individuals with $15 million or more in investible assets are defined as 'high end' for our purposes. Figure 1 indicates the size of the European private banking and wealth management market.[7]

Figure 1: Value and volume of key client segments in European wealth management
European HNWIs – Population and value 2007



Source: Deloitte analysis based on the Scorpio Partnership Wealth Distribution model, 2008.[8]

Accommodating these high-end groups is crucial if wealth managers are to maximise shareholder value. Comprising 72,000 people in Europe, 'high end' clients represent approximately 47 per cent of the financial assets held by all private clients.[9] And in recent years wealth among the high end has been accumulating faster than the rest of the private client market.[10 11]

The high end is significant for other reasons. This elite group is likely to be the most resilient to any downturn in asset prices and is therefore important to sustained revenue and profitability. In addition, this more sophisticated private client group can act as a lens through which the future of service provision can be seen. Demands made by these clients are often a precursor of products and services demanded by the lower end of the HNW client market.[12] Getting propositions right for this client group may therefore pay dividends for a wider client base.

Growth potential

Senior managers of financial institutions and investors in financial services are understandably optimistic – they see several avenues for potential growth:

- It is possible to increase penetration into each client group. Studies of UK-specific wealth patterns suggest almost 50 per cent of wealthy families do not consult professionals before investing.[13] 'Going it alone' is clearly an option and indicates that there is much untapped wealth to be captured by wealth managers.

- Wealth managers can increase penetration among target clients by capturing more of clients' wealth. As a broad average, our interviews with private clients show that just 25-30 per cent of their assets are made available to the wealth management market.[14] Although much of the remaining 70-75 per cent of wealth may be held in traditional illiquid assets (for example, property, art, tied company stock), private clients' assets are rarely static and opportunities arise when asset allocations shift. Our discussions also showed that private clients managed almost five wealth management relationships (4.7 on average) and there may be a latent demand to rationalise this number. Thus, there is scope to increase revenues-per-client by capturing greater wallet share.

- There is an opportunity to target customers more accurately. For instance in 2006, the number of ultra-HNW individuals grew at 11.3 per cent globally and their financial assets grew at 16.8 per cent.[15] Sophisticated segmentation based on source of wealth, purchasing behaviour, or even ethnicity, can be used to target and capture high-growth or high-profit groups.

Given these possibilities for growth, expectations for the wealth management sector are riding high.

Struggle for profit

However, looking ahead, Europe's wealth management market is likely to be a tougher place in which to increase revenues. There are some serious challenges to deal with, which are likely to erode wealth managers' growth and profitability if no preventative action is taken.

First, any decline in asset prices is likely to drag down wealth managers' margins. While wealth managers continue to drive revenues through an 'ad valorem' scale (based on the value of AUM)[16] they have failed to diversify their revenue streams with advisory-based fees. This may leave margins exposed in a downturn. In addition, recent events relating to the credit crunch could undermine investor confidence.

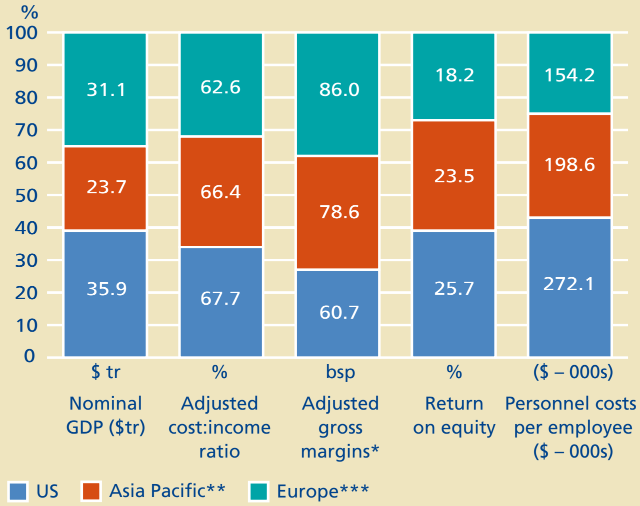
Second, operational issues are likely to restrict wealth managers' ability to attract new clients or their capacity to deliver a quality proposition. For instance, where a banking service is based on one-to-one relationship management, any growth in the client base remains restricted to the rate at which wealth managers can increase their front-line staff numbers. And any change to the client loadings (the ratio of relationship managers to private clients) may impair their ability to serve client demands. This dilemma is also pushing up staff costs. In 2006, average compensation costs rose at 11.5 per cent, whereas average non-compensation costs reduced 0.3 per cent.[17]

Figure 2 highlights the key characteristics of the European wealth management market. Although compensation levels in Europe compare favourably with those of the United States, rising costs in Europe may drag down adjusted gross income margins in the future.

Third, client profitability is not being maximised, owing to two factors. First, costs are not decreasing fast enough. Separate analysis that compares wealth management operations with those of universal banks shows a marked difference in cost-to-income ratios. Unadjusted cost-to-income ratios among key operators in the European wealth management sector have reduced from an average 75.4 per cent in 2004 to 71.1 per cent in 2006.[18] This is still significantly higher than the average for universal banks across their functions (61.6 per cent over the same period).[19] Second, RMs are failing to persuade many clients to take higher value services (which can also have a lower cost-to-serve ratio). Across the client segments, wealth management and private banking are witnessing a rise in less profitable, execution only (XO) mandates and a decrease in higher value advisory and discretionary mandates.[20]

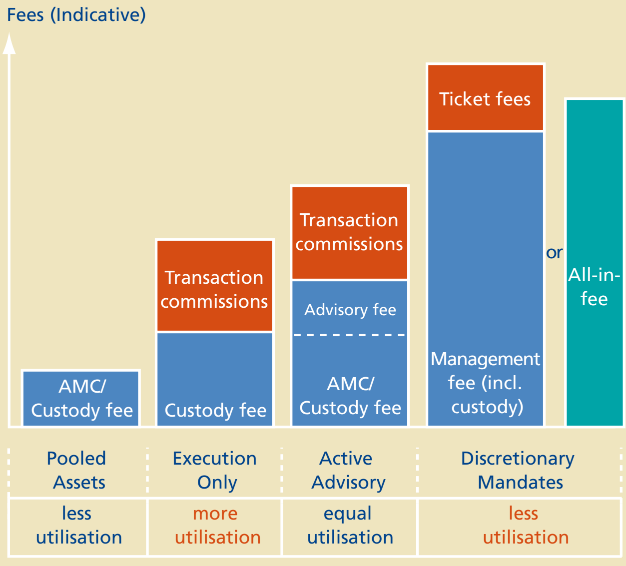
Figure 3 illustrates the types of investment management mandates given by high-end clients and their relative utilisation rates. High-end private clients typically utilise XO and active advisory mandates, which allow them to retain control of their portfolios and take guidance where necessary. Our research suggests that high-end private clients are less likely to commission discretionary mandates than lower-end HNW private clients. Moving private clients onto discretionary mandates is beneficial to wealth managers for two reasons: not only do they command higher fees and revenues but they often can also have a lower cost-to-serve. To increase profitability, wealth managers should strive to advance clients from XO services to higher value advisory and discretionary mandates.

Figure 2: Key performance measures in European wealth management market in comparison with North American and Asian markets, 2006



Notes:
*the ratio of fees/commission income to assets under management
**based on Japan (except GDP)
***selected Western European countries
Sources: The international private banking study 2007, Swiss Banking Institute, University of Zurich, 2007; Economist Intelligence Unit, 2008; Deloitte Research 2008.

Figure 3: Indicative revenue models: relative utilisation of mandates by ultra- and very-HNW clients (compared with other wealth segments)



Note: AMC – Annual Management Charge

Source: Deloitte Research, 2008.

However, client profitability does not hinge simply on moving more individuals onto higher value mandates. Moving up the value chain can also be achieved by selling more advice-based services. In addition, where private clients are uninterested in higher value services, wealth managers can increase profitability by improving client retention (as the costs of client acquisition continue to rise) and by lowering the cost-to-serve wherever possible.

The fourth trend that could restrict growth and profitability is intensified competition. The wealth management sector is attracting renewed attention from across the financial services community – from global insurance companies and banks, to independent financial advisors (IFAs), niche investment consultancies and hedge funds. Multi-family offices are growing rapidly to take market share in the higher-end of the client market. An already busy and fragmented marketplace is likely to become more and more crowded with major implications. Our interviews with private clients suggest the plethora of types of wealth management institution is already confusing to the client base. An army of new entrants is likely to add to this bewilderment. In addition, more players may lead to further intensified competition, adding to the struggle for profit.

Finally, and potentially crucially, our discussions with private clients suggest that a significant portion of the client-base is disconnected from, and possibly lacks trust in, its wealth management institutions. Many clients have come to view their wealth managers as sales people who do not act in their interests, or who lack sufficient investment expertise to offer valuable advice. This perceived lack of expertise manifests differently according to the service model adopted by the wealth management institution, the country where it operates and the sophistication of the client. For instance, in defining the trust deficit, high-end private clients in the United Kingdom emphasised wealth managers' lack of expertise more than private clients in the Swiss market.

Of all the challenges ahead, the perceived trust deficit may be the most fundamental to the future of a wealth management market that seeks to move up the value chain.

The top-end of the HNW client base (ultra- and very-HNW individual segments) seems particularly unimpressed. Such clients are less likely to grant discretionary mandates, and seem the most disconnected and lacking in trust. Unless wealth managers can reconnect to this crucial client-base, worth over $5.5 trillion in financial assets in Europe in 2006, wealth management institutions are likely to struggle for sustainable profits.[21]

Trust deficit

It is widely held in retailing wisdom that "without a satisfied customer, profit is only ever short-term". Our in-depth discussions with HNW individuals revealed that there is a perceived trust deficit between wealth management providers and their private clients.

Trust deficit: three characteristics

Many private clients revealed they are sceptical about their wealth managers. There was no single reason given for this apparent distrust. Some private clients suspected their banks of 'churning' their accounts for increased transaction fees, while others viewed their RMs as unqualified to give appropriate advice. Our discussions suggest this trust deficit has grown out of three main factors.

First, RMs tend to be seen as 'product pushers' meaning that RMs are believed to be too sales-orientated to have the clients' interests in focus. And this means that private clients often view any recommendation with suspicion:

"The staff (at the bank) are just trying to sell you products. Because they are product-led they are not independent. And they can move away from fundamentals. I only ever invest on fundamentals and all too often they are not there when RMs are making a proposal."

Private clients often use the terms 'advice' or 'sales' interchangeably. This ambiguity over sales-orientation is not helped by a lack of pricing transparency. High-end private clients seek greater value for money than most HNW segments, remaining vigilant against fees for bundled products, hidden commissions and the churning of accounts.

Second, clients are often unsure if they are receiving objective advice or best-in-class products from their wealth managers' suite of proprietary or third-party products and services. Private clients are often unsure if front office staff are under pressure to sell them proprietary products when there may be a better alternative on the open market.[22] One private client highlighted the need to understand the wealth managers' approach to sourcing:

"The propositions of all of these banks are unclear. Where are they in the scheme of things? I am just about to move some funds (to a UK private bank) and it's taken a year to arrange a lunch. And it's during this lunch they will tell us what we need to know – what their overall approach is."

Unless private clients believe they are consistently receiving objective product advice and sales, they are likely to remain sceptical.

Third, many private clients do not rate the investment expertise of RMs and therefore take advice 'with a pinch of salt'. Two factors often contribute to this perceived lack of expertise: wealth managers' chosen service delivery models are significant in defining the necessary expertise required of their RMs. Further, the clients' own financial expertise may also inevitably influence this perception.

Many private clients view their wealth managers as providers of banking services first (for example, lending, transaction execution and other services) and investment management second. Many private clients felt they could not trust private banks with their wealth:

> "My private bank is just that – a bank. As long as they do the basics well, I am fine. They want to take on the investment management role, but I am not interested. I have my people that I trust with the portfolio. I regard them as on my side."

Since ultra- and very-HNW individuals are generally more sophisticated than other groups of private client investors, clients' lack of trust in the expertise and focus of wealth managers seems particularly acute among the high end of the client market.[23]

Can clients be satisfied without trust?

Client satisfaction and trust are not synonymous. Some private clients are happy enough with their wealth management services. But this is usually due to an acceptance that a trusted third party – usually an Independent Financial Advisor (IFA) or niche consultant – would be engaged to 'manage the wealth managers'. Or clients simply accept that they are being 'sold to' and that the RM's job is to bring them new products:

"The only thing wealth managers want to do is sell you stuff. I am okay with this. I see 'advice' as my wealth manager showing me new products as and when they arise and me choosing what I want."

This form of client satisfaction is qualified. It exists within a narrow frame of reference where wealth managers are not regarded as trusted advisors and their advice is accepted as 'sales'. In other words, those happiest with service often have low expectations. With a weak foundation, delivering higher value mandates, advice and services to these clients would be difficult.

The trust deficit suppresses current and future profitability
Although unlikely to apply to all private clients, there are practical implications that arise from the trust deficit, which may have an impact on the ability of wealth managers to increase revenues and profitability.

First, distrustful private clients use their wealth managers in ways that do not allow higher value services to be sold, suppressing the profitability of their accounts. With ambiguity over the sales-orientation of their banks, a lack of clarity over the sourcing of products and a sense that front office staff can lack expertise, high-end private clients can typically react as follows:

- They retain key decision-making. High-end clients are more likely to retain strategic and tactical asset allocation and commission fewer discretionary mandates than other HNW segments. This restricts the ability of wealth managers to offer advice and increases their reliance on XO mandates.[24]

- They exhibit 'parts buying' behaviour. Avoiding a one-stop-shop, high-end private clients purchase selected services from each provider to gain access to the best products and to distribute their wealth around the market. Wealth managers consequently struggle to capture share of wallet and fail to achieve an overview of their private clients' whole portfolio of assets and circumstances. This, in turn, restricts wealth managers' ability to advise.

- They seek external advisors to manage wealth management relationships and give second opinions. Such intermediation distances private clients from their wealth managers and potentially impairs the wealth manager's ability to sell or advise.

- They avoid the market as far as possible. This has an impact on the potential size of the client market.

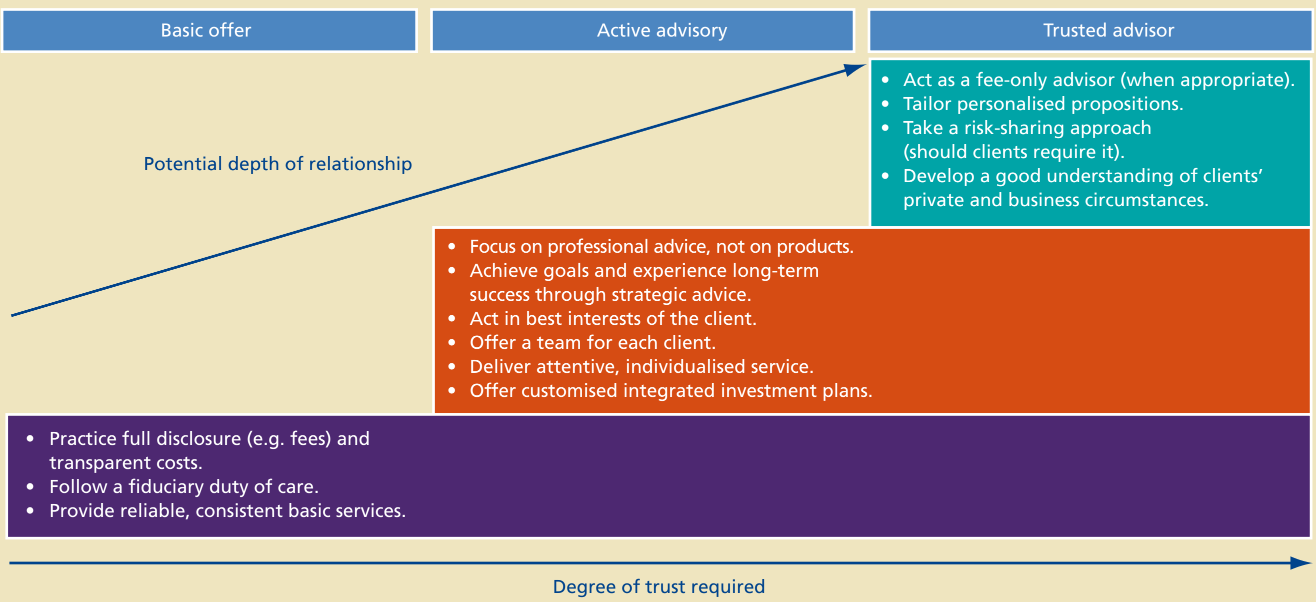
Second, the trust deficit may impact on wealth managers' future plans to achieve 'trusted advisor' status. To try to counteract growing pressure on the price of low-end transaction-based services (for example, the falling cost of brokerage) and increases in XO mandates, wealth managers are seeking to broaden their revenue platform with higher value services. Many of these approaches require greater client trust.

Figure 4 articulates the trusted advisor model and highlights some of the attributes wealth managers should display in gaining greater trust.

Where a trust deficit exists, wealth managers will struggle to move up the value chain to stimulate demand for advisory and discretionary mandates and other advice-based services. The trust deficit may also prevent wealth managers from developing greater retention and loyalty among clients.[25]

As private banks are currently seeking to move up the value chain to become a 'trusted advisor', this is a bad time to discover a trust deficit among parts of the client base.

Figure 4: The trusted advisor model: key attributes



Source: Deloitte Research, 2008.

Reconnecting with clients

To reconnect with their customers wealth managers should re-align propositions so that they are driven by the factors most important to clients. From our discussions we have distilled three principles that typically influence the decisions of private clients: diversification, performance and efficiency. Wealth managers should capture client insights based around these core principles. They can then identify client segments that enable them to tailor propositions for each client group. This tailored approach may enable wealth managers to satisfy private clients' needs. It may also improve their ability to advance each client up the value chain towards improved profitability as propositions are tailored more closely to reflect the requirements of each segment.

Building the foundations: diversification, performance and efficiency

We have distilled the following core principles that underpin the wealth management activities of private clients:

Diversification

Client behaviour in the wealth management market is fundamentally driven by the desire to diversify wealth. Private clients diversify in two main ways:

First, accumulating their wealth elsewhere, clients enter the wealth management market as a safeguard against other losses. Our research suggests private clients place an average of just 25-30 per cent of their wealth into the wealth management market.[26]

"I make my money in business and the wealth managed in the private banking market is there to diversify – in case it all goes wrong elsewhere."

Wealth managers need to build a complete picture of the wealth and personal circumstances of their private clients. A thorough understanding of clients' diversification needs should enable wealth managers to offer better strategic advice and more closely align with clients' interests.

Second, high-end private clients diversify across the wealth management market. They spread risk across a number of banks and wealth managers in case any single institution fails. On average, high-end private clients use the services of almost five wealth managers.[27]

As one private client said:

"If I kept all of my assets with one firm and the firm failed – it would spell disaster. The likelihood of five blowing up (collapsing) is much less. Using several providers is a risk strategy."

Whether traditional levels of diversification will be necessary in an open architecture world (where wealth managers can source investment products through a third party) is debatable, but clients need to be reassured of the strength of their providers. Despite the importance of diversification, private clients indicated that they were willing to rationalise the number of wealth management relationships if this would simplify the amount of time and effort they spend managing their finances.

Performance

High-end private clients consistently rated performance more highly than quality of service and banking relationships. This trend is most clear among the financially sophisticated and the self-directed (clients taking strategic decisions using wealth managers to execute only). Many of these clients view service as a distraction in their search for performance and seek to avoid superfluous services that may eat into their returns. However this preference does not apply to services that add bottom-line value (such as tax advice) or enhance performance in some way.

In addition, private clients who engage third parties, such as brokers, IFAs, investment consultants and family offices, to intermediate with their wealth managers are less interested in the service levels offered by their wealth management institutions. Client preferences for performance over service are also partially driven by the strong desire for value for money.

A client's preference for performance should not be confused with high performance. The basic fundamental requirement is for sustained performance (beta) rather than out-performance (alpha). Achieving beta was said to be first and foremost about being responsive – entering and exiting markets at the right time so that the core of the client's portfolio remains stable.

> "I don't want to enter markets 18 months too late due to a lack of responsiveness. Getting {new} products out to me earlier and exiting existing products earlier would be useful for sustained performance."

Exiting before significant asset price reductions is often most important to a private client. Still influenced by the dotcom crash, and, no doubt, also by more recent credit crunch experiences in 2007/2008, many private clients want their RMs to be more proactive – moving out of products and asset classes ahead of the curve, rather than behind it.

In the search for alpha performance, how fast a product is developed for private client use is also a frustration, as private clients often feel they miss the first-mover advantage.
This is particularly so for those seeking a higher risk-to-reward ratio. However, the search for higher performance usually applies to just a small portion of the portfolio.

To serve clients better, appropriate front office staff and asset management teams should continually review the suitability of products sold to private clients. This form of responsiveness should be visible to private clients seeking performance.

While many banks may seek to distinguish themselves on service levels, performance is a key differentiator in the minds of clients. Differentiating through performance is critical in aiding client retention, even for those who are less pleased with other aspects of the proposition such as service levels or pricing.

"I am often paying far too much for just vanilla products. Why do I tolerate such poor pricing? I swallow the fees if the (investment) performance remains good."

While private clients are often highly price sensitive to banking services, many suggested that they are less price sensitive if performance is good or expected to be so.

Efficiency

Private clients also seek greater efficiency. While banks continue to broaden their range of products and services, their clients care more that the existing repertoire is executed effectively – for banks to get basic processes working more effectively.

Many private clients expressed the same sentiment as this wealthy individual:

> "The most important aspect of the private banking service is operational efficiency."

Clients gave examples of difficulties they had experienced with banking services, such as arranging basic asset finance or in dealing with several currencies. In investment management, clients defined efficiency as quick, accurate execution of transaction requests, fewer administrative errors and client reporting that fitted their needs.

Improved efficiency can be a source of differentiation for all client segments but is particularly significant among high-end private clients whose financial affairs are more complex. Such clients are typically multi-banked and therefore require efficient processes that reduce levels of administration.

Building tailored propositions from meaningful segments

To reconnect, wealth managers should seek to understand how each of their clients views diversification, performance and efficiency. These principles form the basis of high quality insight that can lead to the development of new, carefully tailored propositions that can give private clients what they want.

Figure 5 illustrates various client segments resulting from our discussions and the measures needed to extrapolate useful data on which to base a fresh proposition. Each measure is aligned to the principles of diversity, performance and efficiency to keep client data firmly rooted to the underlying goal – restoring trust in the wealth management market.

Understanding clients' sources of wealth, their risk appetites, the types of mandates commissioned, product and service take-up, as well as other buying behaviours, is essential to optimising segmentation strategies. Such optimisation requires wealth managers to go beyond simple marketing-led segmentation (designed for client acquisition) to use segmentation strategy to build new propositions.

Segmenting clients gives a clearer idea of how each uses wealth management products and services. Segmentation can also be used to make sense of private clients' attitudes towards managing their wealth. This insight can be used to build new propositions that are closer to the requirements of the segment to which the private client belongs. In this way a wealth manager can build a scalable proposition for each segment, while giving a tailored service to each client. Strategic segmentation approaches can allow costs to be controlled while offering better-fitting product and service packages.

These tailored, yet scalable, offerings may also be expanded to embrace a larger group of individuals as new segmentations are found in an organisation's data. For instance, the characteristics of the Entrepreneurial group of individuals may cut across the traditional private client categories – where they are grouped by their net worth, (for example, ultra-HNW, very-HNW, and /or HNW individuals).

Does the agenda need a rethink?

Our discussions with senior executives in global wealth management and private banking suggest that their current growth strategies may need refocusing if they are to reconnect with their high-end clients. Wealth managers told us they have three client-focused priorities:

- To improve RM-based 'high-touch' service levels.
- To extend the product and service range to deliver improved depth and breadth.
- To deepen client relationships by improving softer or peripheral services (such as networking, philanthropy or lifestyle services).

These are constructive strategies for those clients who are engaged with their wealth managers. But for a significant number, such approaches may be unwelcome unless other measures are also introduced. While many private clients are likely to be pleased with high-touch service, those lacking trust may view this as 'more sales time' and could find the process counterproductive. Similarly, clients who do not fully trust their service providers, or have low expectations, rarely seek a one-stop service from an extended service range. Finally, as high-end private clients are price sensitive and less trusting than other HNW segments, their interest in additional services is likely to remain minimal.

Before banks can extend and deepen their client relationships, wealth managers should first prove to sceptical clients they can deliver against the basic criteria. Understanding the ways in which clients seek to **diversify** their investment portfolios, the criteria against which they rate **performance** and their view of **efficiency** and what it means for them, are essential client insights. Focusing on such insights should enable wealth managers to carry out basic services with greater efficiency and provide the foundations for banks to move to a higher value service delivery model.

Figure 5: Illustration of private client segments against diversification, performance and efficiency principles

Key • = Low, ••••• = High

Diversification	**Entrepreneur (non finance)**	**Finance Professional**	**Real Estate (RE) – based owner**	**Inherited wealth (finance)**	**Inherited wealth (non-finance)**
Total assets	••	•	••	•••	•••
Proportion of assets in WM market	••••	•••	••	•••••	•••
No. of WM providers used	••	•••	•••	•••••	••
Share of wallet	•••••	•	•••	•	•••••
Risk appetite	••	•	•••	•••	••
Asset base/ wealth structure	Core private stocks + cash equivalents	Core private stocks + RE/bonds	Core RE + equity	Share in investment trust and equity	Core RE/share in trust co. + equity
Investment objectives	Maintain and diversify against business failure	Accumulate and diversify against capital markets	Accumulate and expose to equity	Accumulate and expose to equity	Maintain and transfer to next generation
Liquidity event	IPO/sale	Retire/change firm	Realise RE asset	Wealth transfer	Wealth transfer
Performance					
Financial sophistication	•••	•••••	••	••••	••
Pricing sensitivity	••	•••••	••	•••••	•••
Level of active management required	•••	•	•••	••	••••
Open architecture preference	•••••	•	••••	••	•••••
Performance products	Hedge	Hedge/PE/comm/ struct. prod	Hedge/Comm.	Hedge/PE/struct. prod/ comm.	Hedge/struct. prod
No. of specialists/ extended services	Tax/Legal/Asset finance	Tax/Legal/Asset finance	Tax/Legal/Trust	Intl. Tax/Legal/ Trust/Offshore	Tax/Legal/ Asset finance
Types of mandate	Disc/AO	XO	Disc/AO	XO/AO	Disc/AO
Efficiency					
Client satisfaction	•••	•	•	•	•••
International servicing needs	•••	•••	••	•••••	••••
Preferred interface with institution	Telephone/Internet	Internet/telephone	Branch/telephone	Telephone/Internet	Branch/telephone
Required frequency of reporting	Simplified/quarterly	Detailed/monthly	Simplified/quarterly	Detailed/monthly Trust/Offshore	Simplified/biannual Asset finance
Interface with the WM market	Personal/IFA	Personal	Personal/IFA	Personal/Inv. Consultancy/IFA	IFA/FO
Core banking divisions used (relationship configuration)	Corporate (Institutional) bank	Invest. bank/ asset management	Corporate bank/ private bank	Invest. bank/ asset management/ private bank/FO	Private Bank/FO

Notes: RE = real estate; PE = private equity; Comm = commodity; XO = execution only; AO = advisory only; Disc = discretionary; IFA = independent financial advisor (or whole of market advisor); FO = family office.
Source: Deloitte Research, 2008.

Transformation agenda

Wealth management institutions seeking to reconnect to clients should target their transformation efforts around several interrelated areas. These are: client insight analysis; segmentation strategy and client value management; retooling for efficiency; transforming the distribution or advice model, and integrating capabilities across banking functions. Leading wealth managers are currently addressing some of these areas and much of the best practices that should be deployed may already exist in other parts of their organisations. Those who coordinate their agenda for change – with both their front and back office operations – are likely to succeed.

1. Client insight analysis

Issue

For an industry renowned for its personal and tailored client relationships, wealth management has been less than impressive at gathering meaningful client insight and extrapolating from it. A lack of client knowledge has contributed to the perceived disconnection between wealth managers and their private clients. Extended client insight should be captured to reconnect with clients.

Extended 'client needs analysis', which captures quality client insight, takes significant effort. Leaders of this process should create a clear vision of how the data will be captured, stored and used.

Practical recommendations:

Front office

- Consolidate existing client data to identify the extent of the client knowledge gap. In many banks, this may require transfer from written notes to a simplified electronic application or platform.
- Capture client insight for use throughout the firm. Many RMs may be reticent to improve on and release privileged client data to the wider bank.[28] RMs should be encouraged with the right incentives, assurances that client data is secure, and through compliance with Know your Client (KYC) processes. An intensified data collection process may require RMs to enter data directly onto an electronic platform.
- The effects of staff churn on client insight should also be reduced. Information that is not captured in the corporate memory (that is, institutionalised) can be lost as staff move on. Reducing staff churn may facilitate the building and maintaining of client insight. If key front office employees do leave, re-alignment of staff incentives, team structure and processes can also help to preserve client insight.

Back office

- Building client insight should be strategically prioritised and rewarded. Leadership should advocate and drive the related IT and HR initiatives required to support front-end staff. In practice, this means IT and the front office should work together to decide what management information is required and build secure data systems that front office staff can work with.
- Devise measures and management information to understand how existing clients interface with the bank. Combined with data on product and service take up and channel use mix, management information can facilitate proposition development and inform channel strategies.
- Set up easy-to-use IT infrastructure on which robust management information can be captured for creating client segments.

2. Segmentation analysis and client value management

Issue

Segmentation strategies are increasingly being used to inform targeted marketing initiatives at private banks, but such analysis is rarely used to provide services more closely reflecting clients' needs. Building on client insight analysis, propositions can be designed around the needs of each client segment to facilitate tailored offerings.

Further, a standardised approach to service delivery often fails to maximise client profitability. Client value management can monitor and chart the profitability of clients as they are continually reviewed against benchmarks for their segment.

Practical recommendations:

Front office

- Create client segments (for example, Entrepreneurs, Finance Professionals, and Inherited Wealth). This entails comparing the behaviour of individual clients within the segment to which they belong. An accurate picture of which products and services each client uses is a basic, but often missing, element of interacting with clients.

- Implement tailored propositions based on client segments. This entails identifying product and service bundles and service delivery (channel) strategies to be tailored to each segment, and allocating resources according to the client's need or preference.

- Create management information for improved client value management processes. This requires continuous review of client needs and attitudes as clients progress through the customer lifecycle.[29]

Back office

- Use segmentation data in product and proposition development and in channel delivery (that is, distribution) strategy to design and build tailored propositions serving each segment.

- Assess client profitability and cost to service for improved client value management. Using improved performance data to understand the cost-to-serve of each client may help identify each client's profitability compared with the average for the client segment. A methodology for understanding the product lifecycle of clients – the sequence in which they, and their segments, use products and services – should also be developed to understand what other products are either missing or being sourced through a competitor.

3. Retool for efficiency and effectiveness

Issue

Private clients suggested that all too often basic services do not run smoothly. It is likely that many private banks are in a vicious circle in which they continually extend their product and service range, stretching resources and reducing efficiency. In addition, the increased complexity of high-end private clients' financial needs means that their requirement for smoother, more efficient service is even greater.

Banks should strive for operational excellence, retooling for more efficient delivery of core services, simplifying and streamlining operations. In addition, wealth management institutions may also develop aggregated services for clients seeking a single view of their assets. Several strategic decisions should be made.

Operational efficiency should first be placed back on the strategic agenda – with a decision to differentiate through more effective service. A value chain strategy should be agreed, which is based on a review of core and non-core activities and uses performance and client insight data. From this, a focused approach to transformation can be made.

Practical recommendations:

Front office

- Automate basic service processes according to client preference. By using automation, in addition to workflow management, front office staff resources can be freed to improve efficiency and streamline service provision.

Back office

- Basic workflow processes should be reviewed and improved for smoother running of core banking services. This may involve greater standardisation of such processes and a review of the difficulties front office staff have with existing workflow arrangements. Workflow (imaging) technology should be embedded to achieve straight-through processing and seamless service.

Front office (continued)

- Create a structured, client-centred advisory process. Based on an enhanced single view of the client, improved and consistent advice should be delivered throughout the customer buying-cycle. This may require standardisation of a clearly articulated advice process that levers regulation – such as KYC, and technology – such as Voice of the Client (VOC) programmes.
- Improve touchpoints with the client. Customer relationship management technologies should be reviewed to simplify and streamline basic client touchpoints (for example, accounts, client reporting, tax statements, applications and client-end form filling, lending decisions, and so on).
- Enhance and maintain the quality, skills and focus of staff. Improving efficiency may require a shift in staff attitude. Reward systems should be realigned to reflect a new emphasis on services, not just sales.

Back office (continued)

- Build a modular and dynamic technology platform as a foundation for effective service. As implementation is likely to have a long lead time (a two-year roll out is not uncommon) the platform should be flexible. The platform should also be dynamic and scalable: modular system components may be required to meet continually changing client needs and regulatory requirements. For instance, infrastructure for account aggregation services (for example, wrap accounts) should be considered for the multi-banked client segment. Such components can be sourced either in-house or through a third-party provider.

4. Transform the distribution and advice model

Issue

Traditionally, RMs have acted as gatekeepers, owning the relationship with the client and offering advice based on their experience, supported by a research function. In an increasingly complex investment landscape, many private clients no longer trust the expertise of their RMs to give advice on this basis.

To restore trust, wealth managers should review the extent of RM activities, transforming them to lever more expertise from the wider team of wealth professionals. Any adjustments to the RM role may have significant consequences for other specialists and banking staff. The success of such changes may therefore be dependent on senior leadership, appropriate incentives and uniting staff under new team arrangements.

Practical recommendations:

Front office

- Deliver the whole private bank to the client. This requires a review of the activities, breadth and coverage of the RM role. For example, administrative activities can be reassigned to free more time. Further, the product coverage offered by RMs may be limited so that they can rebuild or maintain their expert status in specialised products.
- Improve teamwork and collaboration. Restricting the breadth of the RM role should be combined with improving the way teams work. RMs should be backed by other specialists throughout the wealth management institution including tax, legal and trust specialists, portfolio managers, risk analysts and so on.
- To promote more efficient teams and cross-selling, a review of the internal hierarchy should be carried out. Staff are often siloed, both in terms of divisions and functions, and level of seniority. RMs and others who own client relationships can be particularly defensive. The most successful teams are likely to be those who figure out how to break down these barriers.

Back office

- An improved team-based approach to relationship management and service delivery may require strong support processes. Systems should be put in place that can facilitate effective information sharing across teams of specialists.

5. Integrating capabilities across banking divisions and functions

Issue

High-end private clients often utilise services from several different banking divisions of the universal or private bank including asset management, corporate (institutional) networks, investment banking, and the retail franchise. Banking staff often operate in silos, and are yet to integrate their capabilities across these divisions. They risk inconsistent delivery of the firm and the possibility that some clients, who do not easily sit in one camp, are falling through the gaps.[30] Further, cross-selling within such an environment can be a major challenge, as is consistent delivery across banking units.

An integrated capability across functions and divisions should be developed to provide seamless service and generate further business.[31] Such delivery should be informed by a single view of the customer. Driving behavioural change across a number of banking divisions and capturing data so that banks can obtain a single view of the customer could be a key to providing improved services to high-end private clients. Strategic decisions about the service model employed by the group should be made.[32] To drive these changes such strategies should be led by senior leadership.

Practical recommendations:

Front office

- Banks should seek to achieve a single view of their customers. This may enable the bank to work out the value of the client to the whole group. It also helps in allocating resources to maximise value. In addition, creating a single view of the customer is necessary to create tailored propositions for clients who want access to specialist investment banking or corporate (or institutional) finance expertise.

- To achieve a higher level of integrated service delivery, sales forces from around the group must be able to work together. Leadership, rewards and incentives should work in unison towards such a goal. To embed behaviour changes, key performance indicators (KPIs) should be aligned to the teamworking goal.

Back office

- Systems should be put in place to facilitate a 'one bank' approach. Developing an integrated platform that spans divisions of the banking group is not appropriate for a number of reasons. However, developing integration capabilities across divisions through middleware is a realistic goal. Getting sales forces to work together will require consistent approaches to the gathering and use of management information. It will also require appropriate technology and infrastructure to reduce silos and inconsistencies.

The key areas for transformation recommended above represent significant undertakings for the wealth management industry. So, too, are the issues they try to address and the goals they seek to achieve. Capturing client insight, devising client value management techniques and creating segments are fundamental if wealth management institutions are to provide both the personalised, tailored approach private clients seek, and build sustainable business models that are scalable and more profitable. Retooling to deliver effective service is also necessary to convert an often sceptical client base and rebuild trust. Finally, creating integrated wealth management institutions that lever a wider range of expertise may restore clients' trust in the capabilities of staff and prevent them from 'falling through the gaps'.

Wealth management institutions may already have many of the attributes needed to reconnect with clients. It may be the case that these factors need to work more efficiently together to deliver the full power of the organisation. Bringing together the right people, processes and technology, in both the front and back offices, is the key.

Conclusion

There is evidence to suggest that the recent growth in Europe's wealth management and private banking sector will continue. Significant opportunities exist to tap new client markets, drive deeper into existing client categories and increase share of wallet. However, there are also several serious challenges that could mean wealth managers will struggle to increase profits. A decline in asset prices – possibly triggered by the credit crunch, operational issues that restrict growth and profitability among certain client segments and a client base that is increasingly disconnected, are all factors that may influence the sector in the future.

Client disconnection is the most fundamental issue. It seems a trust deficit has emerged from three factors: RMs are often seen as product pushers, wealth managers' advice is sometimes seen as lacking in objectivity and clients are sceptical of wealth managers' expertise in an increasingly complex investment landscape.

The trust deficit causes high-end private clients to behave in ways that could impact wealth managers' profitability. High-end private clients can retain decision making, give less discretionary mandates, and revert to 'parts-buying' behaviour, trading off one advisor against another. The deficit also causes many clients to seek external advisors to manage their wealth managers, or they avoid entering the market altogether. Clients' lack of trust, justified or not, is another obstacle to wealth managers' ability to broaden their revenue streams and increase profitability by moving toward the trusted advisor business model.

To reconnect with clients wealth managers should re-align their propositions so that they are driven by the factors clients deem important. Our discussions with private clients suggest that new offerings should be based on three core principles: diversification, performance and efficiency. Each private client is likely to identify with these principles in different ways. We recommend creating improved client insight and segmentation strategies that can establish the characteristics for specific sub-groups of clients. Examples of segments include: Finance Professionals, Entrepreneurs, Property Owners and Inherited Wealth. Segmentation strategies that are rooted in the clients' basic need for diversification, performance and efficiency, may enable wealth managers to tailor scalable propositions that reconnect with the customer base.

In addressing private clients' concerns, we recognise that wealth managers need to respond without sacrificing profits. We recommend five areas for transformation that should enable this: building client insight, segmentation strategy and client value management, retooling for efficient service delivery, transforming the distribution and advice model and integrating capabilities across banking functions. While wealth managers are working towards some of these transformations, few are taking a co-ordinated approach to all five.

Wealth management institutions already have many of the attributes needed to reconnect with clients. It may be that these need to work together better to deliver the full power of the firm. Hence the themes running through the five areas are integration and teamwork. Bringing together the right people, processes and technology in a coherent way is the key.

In an uncertain financial services environment, shareholders are looking to the wealth management and private banking sectors for sustained growth and profitability. To deliver shareholder value, senior wealth management executives should focus their strategy and tactics on reconnecting with their key client base.

Notes

1 International Private Banking Study, Swiss Banking Institute, University of Zurich, 2007.
2 Western Europe – excluding emerging markets.
3 Defined here as those with over $15 million or more in financial assets.
4 Defined as individuals with over $1million or more in financial assets.
5 Deloitte Research, 2008. Based on a sample of 19 of Europe's leading wealth management and private banking firms. At the time of publication, many leading wealth managers were reporting FY07 double-digit revenue growth.
6 Ibid.
7 Deloitte Research, 2008. The ultra- and very-HNW population comprises 3 per cent of total HNW population in Europe. Figures based on analysis by the Scorpio Partnership Wealth Distribution model, 2008. By value of assets, ultra- and very-HNW individual wealth represents 47 per cent of assets of HNW population in Europe.
8 Data is based on the Scorpio Partnership Wealth Distribution model, 2008. Combines macro-economic and micro-economic approaches to estimate the 'true' distribution of wealth. The distribution data is based on parametric distributions of wealth, building notably on the work of Vilfredo Pareto and subsequent academic developments in the fields of both economics and statistics. Discrepancies might appear when comparing data across different time periods, as more accurate historical data becomes available.
9 Deloitte Research, based on the Scorpio Partnership Wealth Distribution model, 2008.
10 World Wealth Report 2007, Merrill Lynch/Cap Gemini, 2007.
11 As financial institutions are rarely able to analyse total assets by client segmentation, it is difficult to produce reliable industry-wide data on the level of AUM held by such clients.
12 High-end HNW individuals typically lead others and the retail customer market in using more complex or higher risk products and assets (such as PE, hedge funds, structured products, commodities).
13 Tulip Financial Research, 2007.
14 Our survey assessed the assets held by each private client interviewee. Wealth not placed with wealth managers was also held in retail banks, building societies or in less liquid assets such as private firms, real estate and collectibles.
15 Based on a definition of ultra-HNW individuals with $30 million in free investible assets. World Wealth Report 2007, Merrill Lynch/Cap Gemini, 2007.
16 Assets under management.
17 Deloitte Research, 2008. Based on a sample of 23 European service providers.
18 Regional variation in costs is extensive. The UK average was 64.5 per cent, Swiss 65.7 per cent, Benelux 51 per cent and Germany 72.6 per cent in 2006. International Private Banking Study, 2007, Swiss Banking Institute, University of Zurich, 2007.
19 Deloitte Research, 2008. Based on a sample of 23 European service providers.
20 ComPeer analysis on the UK market, 2007, International Private Banking Study 2007, Swiss Banking Institute, University of Zurich, 2007.
21 Figure based on the Scorpio Partnership Wealth Distribution model, 2008.
22 Many banks have robust screening/picking processes through which open market products should be tested before being offered. Increasing transparency around the screening/third party sourcing process may help change perceptions where appropriate.
23 The quality of advice RMs are required to deliver is also likely to be highly dependent on the service delivery model each private bank employs.
24 XO mandates have a higher cost-to-serve.
25 As it is not feasible for wealth managers to become 'trusted advisor' to all private clients, a one-size-fits-all approach to developing trust is not suggested. Clients who simply use XO mandates or depository services may require only a basic level of trust (in the execution of services). And successfully completing on the basics may be enough to retain these clients. In contrast, wealth managers will need to display more of the attributes of trust (listed in Figure 4) before clients with the potential for (more) active advisory and discretionary mandates deepen their relationships with their wealth management providers. Hence, adhering to a strict and costly catalogue of prerequisites to achieve the highest possible trust level ('trusted advisor' status) is therefore neither required nor efficient for all clients.
26 Although this varies significantly depending on types of assets held, occupation, lifestage, and other characteristics. Deloitte Research, 2008.
27 Deloitte Research, 2008.
28 Especially in banks where the role is highly autonomous.
29 For more on customer lifecycles in financial services, see: Loyalty Quest, Deloitte Research, 2005.
30 Those that gained market share had three differentiating factors: better investment performance; they were focused on the ultra-HNW sector, and they had solid processes in place that maximised the benefits of their retail, commercial and investment banking needs. European Private Banking Survey, McKinsey, 2007.
31 Excluding investment banking in the Swiss private banking market.
32 For example, models with decentralised service delivery often give autonomy to RMs. Using these models wealth managers may find it difficult to obtain cooperation/change from RMs used to such autonomy.

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