Winning in wealth management
Strategies for building profitable business operating models

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Contents

Foreword

The financial crisis has provoked a major turning point for the financial services industry, changing the very basis of competition from growth to profitability. At the same time, the industry has had to withstand significant regulatory change and political pressure. Wealth managers now must deal with a short- to mid-term profitability trap, which seriously challenges the entire industry. Our research will show that clear winners and losers will emerge.

Individual wealth management providers must focus their efforts on key profitability levers and transform their business operating models (BOM) to avoid being caught in this profitability trap, and to succeed in the changing competitive landscape. This structural shift requires a fundamental reappraisal of the strategic drivers of success in wealth management.

This report investigates the root causes of the unprecedented decrease in Swiss-based wealth managers' profitability and explores differences in profitability and key characteristics among individual wealth management providers. Our research concludes with the perspectives on how to build and operate a profitable wealth management institution.

To identify the key characteristics of "winning" wealth management providers, this report will answer the following six key questions:

- How has the profitability of wealth managers evolved over time?
- What are the key levers which have a direct influence on profitability?
- What is the impact of those levers on wealth manager's profitability?
- Which business operating models are predominant in the market?
- What are the common features of "winning" business operating models?
- What are the main strategic initiatives focusing on business operating model transfromation?

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About the research

This report summarises the results of a major quantitative study based on an in-depth analysis of Swiss headquartered and often globally active, wealth management providers.

Our research goes beyond simple profit margin analysis. It also evaluates profitability drivers (financials) and profitability levers (non-financials) and examines their impact on wealth managers' value generation by means of statistical analysis.

The empirical work is based exclusively on publicly available quantitative and qualitative data for the period between 2004 and 2008. The selected time period allows for a comparison of Swiss-based wealth managers' pre- and post-crisis profitability levels in order to highlight the characteristics of "winning" players in both a bullish (2004-07) and bearish (2008) market environment.

The scope of our analysis includes 103 wealth management providers in Switzerland, accounting for 73% of the total number of players in the Swiss wealth management market.[1]

The selected time period allows for a comparison of Swiss-based wealth managers' pre- and post-crisis profitability levels …

Scope of this research

Wealth manager selection criteria	• Our analysis covers pure play private banks, foreign banks with wealth management operations in Switzerland, selected cantonal banks, and asset managers with private banking activities. • Wealth managers were selected based on: – Client assets in excess CHF 1bn. – Public availability of financial data and information. – Sufficiently granular private banking segment reporting. • Institutions not meeting these criteria (e.g., small banks, smaller cantonal banks and UBS/Credit Suisse) were excluded from the analysis.
Client assets	• Client assets are defined as the sum of private and Institutional assets in discretionary mandates, assets under advisory and assets only under custody. • For reasons of simplicity, they are collectively referred to as Assets under Management (AuM) throughout this report.
Publicly available information	• The information used in our research has been retrieved from company reports, SNB filings and FINMA reports. • The data covers the time period between 2004 and 2008.

1 This research covers 103 of the total of 141 market players; as defined by "Wealth Management in Switzerland", Swiss Banking Association [2009], p.11

Executive summary

Caught in a profitability trap

Wealth management providers are facing significant challenges. The industry's average profit margin decreased by 27% from 2007 to 2008. It is expected to recover in 2009 by a mere 3%–10% and is then expected to continue its recovery in 2010 and beyond. We expect many wealth managers to be caught in a short to medium-term profitability trap if no decisive countermeasures are undertaken, because the financial market upturn does not fully compensate for the industry's hampered revenue generation. In addition, many wealth managers also struggle with an inflexible cost base, which has an even greater negative impact on their ability to restore profitability.

Determine key profitability levers

In order to address the resulting profitability challenge, wealth mangers have to identify and address those key profitability levers which directly impact value generation. By means of statistical analysis we have quantified the positive or negative contribution (in basis points) of a pre-defined set of profitability levers to a wealth manager's overall profit margin. Our analysis suggests that the following eight levers strongly drive profitability in a manner that either adds value or reduces it:

- **A clear focus on Affluent/High Net Worth clients and an Institutional client base** are very strong profitability contributors in any kind of market.

- **Producing & offering traditional products** is very market sensitive and has to be managed very carefully

- **Producing & offering market tracking products** is a significant profitability slayer, indicating that the industry is facing a lack of scale.

- **Producing & offering extended services** will, in the near future, also be a key differentiating factor as this represents one of the most powerful means of overcoming clients' trust deficit.

- **Outsourcing single or multiple back office services**, when planned and executed correctly, yields considerable added profitability and is an indicator of operational excellence in this part of the value chain.

- **Maintaining an international footprint** – in the context of a stricter regulatory environment – characterises a profitability cultivator in the near term.

- **Running a proprietary trading function** turned out to be a loss maker over the last two years.

The levers described above form an integral part of a wealth manager's business operating model (BOM) which breaks down the structure of a market player's organization into its elements, covering the entire business value chain (clients, channels, product/services, processes, organization and other elements). Depending on how a wealth management institution combines individual profitability levers to design its business operating model, it may achieve different profitability levels. For the Swiss market, profit margins ranged from 14bps to 54bps in 2008.

Winning business operating models

Our analysis suggests that there are ten predominant business operating models in the wealth management industry. The most successful of these is distinguished by its resilience in the light of the market turmoil in 2008. The model entered 2008 in a strong position, having already performed extremely well in 2007, when it exhibited an absolute profit margin of 58 bps (54 bps in 2008). This model also demonstrated attractive annual profitability growth of 6% (6%) in the period between 2004 to 2007 (2004 to 2008), respectively.

This most successful business operating model's setup can be described as follows:

- Internationally present (domestic and global onshore as well as offshore) wealth manager.

- Focusing on Affluent/HNW as well as Institutional clients.

- Offering custody, advisory and brokerage services as well as discretionary mandates.

- Producing and offering traditional products (own mutual funds, absolute return mandates, managed funds portfolios).

- Outsourcing single or multiple back office services.

Our analysis found no evidence that either a strong focus on client asset growth or the radical quest for more simplicity (equaling the simplest BOM setup) have helped to achieve superior profitability.

We have observed that more than half of the wealth management players in this study face serious challenges to sustainable profit generation. Their models are neither robust, resilient nor flexible enough for the new era. These players therefore have to expect below-average absolute profitability and continued negative profit growth in the near future, unless a strategic operating model change is undertaken.

Eight strategic initiatives to escape the profitability trap

In order to extricate themselves from the short to medium-term profitability trap, wealth managers are forced to transform their current BOM.

Eight strategic initiatives which impact the identified key profitability levers act as catalysts of change:

Strategic initiatives
• Sales & Service Effectiveness.
• Improved Organizational Model Execution.
• Product Sourcing & Management.
• Product Profitability Management.
• Service Delivery Model Effectiveness.
• Proprietary Trading Reorientation.
• Operational Excellence in Back Office.
• On/Offshore Business Model Redefinition.

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Thank you to the following contributors: Afsoun Hatami, Daniel Diederichs, Stella Pagnamenta, Jan Witt and Patrick Spiller

Designed and produced by The Creative Studio at Deloitte, London. 1739A