

# Inside

CEO  
CFO | EDITION  
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Interview with Véronique de la Bacherie, CEO of Société Générale Bank & Trust Luxembourg

Truths and consequences  
Four drivers of change that threaten business as usual

Cross-border business considerations in the private banking and wealth management industries

Capturing value in a shifting environment

Path to value for wealth management centers

Wealth management and private banking  
Connecting with clients and reinventing the value proposition

Tax Reclaim, an innovative differentiator for your institution!

Private banking transformation  
Reinvented proposition for higher customer value, B2C and B2B

Millennials and wealth management  
Trends and challenges of the new clientele

The Middle East  
Challenges and opportunities for global and local asset managers

Investment management  
Equilibrium in the operating models of Luxembourg management companies

MiFID II  
To protect and to serve, but at what cost?

Le Freeport Luxembourg creates new perspectives for the Luxembourg economy

Crowdfunding, an emerging market in Europe?

Maximization of the Finance function through Business Partnering

How to improve business performance thanks to a holistic follow-up of the CFO

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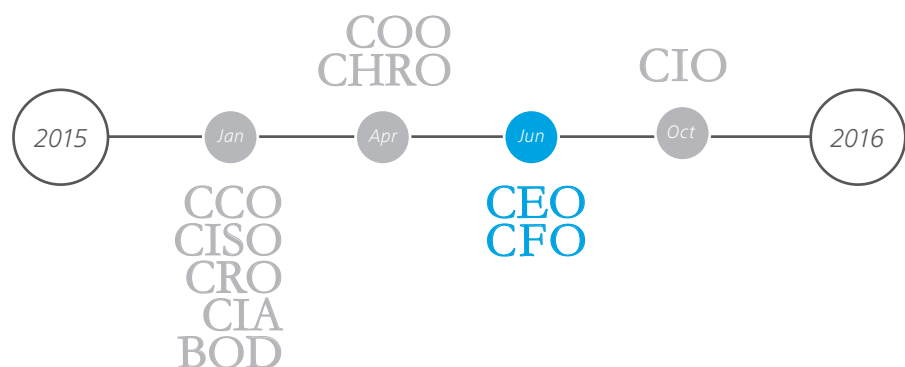
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## Foreword



Dear readers,

Welcome to this new edition of *Inside* dedicated to Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs). The financial services industry has always been a crucial industry at Deloitte, especially in Luxembourg. *Inside* has become an essential forum for addressing a wide range of businesses, from private banking and wealth management to asset management. In addition, we are also strongly committed to exchanging perspectives from global financial centers, whether from Luxembourg, Switzerland, the Middle East or the United States.

This edition includes an insightful interview with Véronique de la Bachelerie, CEO of Société Générale Bank & Trust Luxembourg. She points out that ambitious regulatory requirements, exceptional economic conditions and unstable geopolitical relations pose major challenges to today's industry and financial services leaders. These complex challenges form the common thread of this edition.

Without a doubt, we are at a crossroads. Regulations have quickly evolved since the 2007-2008 financial crisis. CEOs and CFOs have to rethink the positioning of the institutions they lead. In this magazine, several of the authors highlight the growth opportunities that now exist. The real challenge for financial services players is to reinvent their value proposition and show their ability to adapt, to face current challenges—e.g., through cross-border distribution or tax reclaim services.

Constant change makes it increasingly challenging for top executives to design and implement a strategy. It is certainly difficult to articulate a strategic vision in the midst of transitions and transformations. But it remains vital to have an inspiring vision. Success amid change is all about leadership.

With each issue of *Inside*, we aim to break new ground and bring you fresh perspectives. Once again, thank you to all our contributors for their enthusiasm and insight.

We hope you will find this edition inspiring and thought-provoking.

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# Editorial

Dear readers,

Preparing for opportunities: this is the theme developed throughout this new issue of *Inside* which is dedicated to CEOs and CFOs in the financial services industry. We aim to provide innovative insights that will allow you to proactively react to an environment that is experiencing “a significant amount of change,” as Véronique de la Bachelerie notes in her opening interview.

Companies face numerous opportunities in an increasingly globalized world: cross-border distribution, emerging wealth management centers and the Middle Eastern asset management market, to name just a few. These opportunities will also force companies to adapt to new challenges, such as an increased need for compliance with regulatory requirements or higher geopolitical uncertainty.

New regulations that define the playing field continue to emerge. To be prepared, we are focusing on the lessons being learned from MiFID II and the opportunities that are emerging from new regulations. Moreover, identifying new business models and best practices will allow CEOs and CFOs to continue to drive growth and grasp opportunities in this evolving environment.

Financial services providers must adapt as new sources of demand emerge and clients' needs change. Industry players need to rethink their connection to their customers and ensure that they are delivering value. Lastly, companies must understand the specificities of new customer segments, such as millennials, and how to bring value to these new segments.

We hope that you will enjoy reading this edition of *Inside* and will gain insights from it.

Yours sincerely,



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# Interview with Véronique de la Bachellerie, CEO of Société Générale Bank & Trust Luxembourg

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## YOUR INDUSTRY

**Q: What are the major challenges faced by your industry and how do they impact your business?**

We are experiencing a significant amount of changes at the moment, some of which can be observed on a more general, cross-industry level, and some of which are specific to the financial services industry.

One of the most complex challenges is to reconcile the regulatory requirements, notably capital requirements, and our shareholders' needs and return expectations. This is, for example, observable from our group's results but applies to the industry more generally: despite revenue growth, we have a good but stagnating ROE of 7.7 percent. As other industries have an ROE ranging between 10 percent and 12 percent, investors inevitably demand comparable returns from banks. From 2005 to 2008 banks had an ROE of 20 percent to 25 percent, however, a higher return always brings along a higher risk. **The regulatory wave following the crisis might have surpassed the intended objectives, making it difficult to achieve rates of return that would satisfy investors while coping with increasing capital requirements.**

Secondly, we are living in an exceptional economic environment with negative interest rates, meaning that clients ought to pay when making a deposit at a bank. In particular, the very low interest rates for credits inflict huge pressures on revenue generation for retail banks, coming back to the first challenge of low ROE. Moreover, the situation poses problems for IT systems which were not conceived with the idea of negative interest rates in mind.

At the same time, the geopolitical environment is unstable in various regions of the world and changes are unpredictable. Société Générale has a global client base and relies on its international network, part of it being Central and Eastern Europe which at the moment is less stable. This was the case for other regions not long ago and might occur somewhere else in the future. The enigma is such that because rates of return in Western countries are low, companies are forced to enter emerging economies. The challenge is to achieve growth while operating in Western countries where revenues are stable but stagnating and operating in countries with higher rates of return but equally higher geopolitical risks.

**Q: How are client needs evolving and what are the commercial implications?**

The biggest change is that there is a growing share of elements in the banking industry that clients do not perceive as adding value, such as the Single Euro Payments Area (SEPA) initiative or compliance with the Markets in Financial Instruments Directive (MiFID II).

In parallel, clients' expectations are rising and regulators are increasingly pushing financial actors to only charge clients for services that deliver value. As a result, banks are forced to provide services with high internal costs often relying on heavy legacy for free, e.g. secure and performing IT platform. This comes back to the question of profitability, however, from a client perspective, it is also crucial to be able to create a competitive advantage by positioning ourselves as an actor that offers high value-added products and services.



**Véronique de la Bachelerie**  
Chief Executive Officer  
Société Générale Bank & Trust Luxembourg

This being said, “digitalization” equally changes the banks’ relations with their clients and new actors are arriving and occupying niche positions that are still largely unaffected by regulations. The challenge is to adapt to this constantly changing world with new competitors and innovative ideas. To give an example, the banks have long built their business on offering various payment options. **With new actors such as PayPal arriving on the market and offering a similar solution, but as a pure utility supporting their core business and not as a source of revenue, banks have been forced to rethink their own business models.**

Moreover, as clients are getting used to the possibility of personalizing the majority of the products they buy, it has been **a challenge for financial institutions to deconstruct their standard service offering and provide clients with tailor-made solutions while at the same time being able to “industrialize” this approach**, leading back to the ROE issue discussed previously.

While doing this, it is also crucial to offer outstanding service to clients through all the channels available and at all times. Information about the client’s activity has to travel instantly to all channels, be it in a local branch or online, regardless of the channel where the initial impulse was given. An integrated data model and data warehouse is therefore key. This is even more challenging as the banks’ IT architecture and processes were often developed with the idea of offering banking services through physical branches only. Many businesses were historically established

in different business lines or different companies, which now need to communicate. Integrating “legacy silos” is both a challenge in terms of creating positive customer experience as well as an important component in ensuring comfortable ROE in the long term.

#### YOUR COMPANY

##### ***Q: What are some of your initiatives to overcome the challenges in the market?***

Société Générale Bank & Trust (SGBT), the Luxembourgish entity of Société Générale, is a bank specializing in high value-added activities, notably private banking, structured financial products, commercial banking, and securities services. The challenge is to offer these value-added products and services while, at the same time, ensuring competitive prices for clients and keeping the internal costs as low as possible. One solution is to progressively delocalize or outsource those activities that are not perceived as adding value by the client to lower-cost countries or to share them with business partners. Société Générale uses this strategy in the case of payment systems, for example in online banking, where we share the infrastructure with other banks in the market and in particular share the regulatory costs. As clients do not perceive these services as adding value, **pooling between institutions allows the banks to reduce costs while enabling them to focus on those aspects of the business that provide added value and differentiation**, such as relationship management.

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As the world is constantly evolving, we first and foremost encourage employees to adapt to the changes in our industry and it is our role to support them in this process

***Q: How is your company positioned in the industry today? What are your company key differentiators?***

To give you an example of how Société Générale distinguishes itself from its competitors, I would like to bring up the case of Boursorama, which is part of our group. Boursorama is an online bank with quite standardized products and a strong innovation capacity in terms of technological development. With increasing “digitalization” starting already in the beginning of the 2000s, it was important to develop an online presence for banks, even if this model would create competition vis-à-vis the standard banking model based on physical agencies. This is actually the case for Crédit du Nord, another member of the Société Générale network, which is a regional retail bank whose business model is based on proximity to its customers, and in consequence even charged for online services for quite a long time. Initially, it would have made the most sense to suppress the development of an online retail bank, such as Boursorama within the group, seeing it would only increase competition. However, Société Générale supported the idea and endorsed the development of Boursorama as a startup-like external structure outside of the Société Générale network. Another advantage was being able to start with a “blank sheet”, not having to support high legacy costs from the past. Only when Boursorama achieved a “mature” stage, around the year 2011, we saw the grouping of the retail banking network of Société Générale within the same division in order to create synergies. This approach led to the development of one of the most successful online banks in France and resulted in a high-performing multi-channel system for the group in general.

## TALENT

***Q: What are the implications of the industry challenges on your talent and development strategy?***

As the world is constantly evolving, we first and foremost encourage employees to adapt to the changes in our industry and it is our role to support them in this process. This is the case both for support services as well as for experts within a specific field. All employees must be given the chance to gain new expertise and adjust their professional orientation if need be. SGBT’s employees are relatively young, between 35 and 40 years on average, and very flexible and open to new challenges. This is crucial as they can be trained for more value-adding services while building on their existing skills. Concretely, we implemented an initiative last year that encourages internal mobility, involving three different parties: the HR department, the coaching manager, and the employee in question.

***Q: Can you elaborate on the leadership skills required to meet the challenges of today's financial environment?***

The first key characteristic of successful leaders is their ability to adapt, and the second—much correlated—element is their openness to the world. Change and competition can arise from anywhere, anytime, and typically when we expect it least. Until now, banks have implemented the processes and operating models followed by other industries with 10 years of delay, one of the examples being off-shoring. **Closely monitoring other industries and learning from their experience will allow the financial sector to adapt more quickly and at a lower cost.**

Another important leadership skill is the affinity for innovation. All employees should be encouraged to be innovative, not only those in top positions—innovation can come from anywhere and this belief should be shared throughout the company. For this reason Société Générale has implemented a system called “*Innovons à tous les étages*” (“Let’s innovate at all levels”) that encourages and rewards innovation throughout all hierarchy levels of the company.





The last two characteristics of a successful leader are good intuition and team spirit. Intuition is crucial, as in a fast-paced world, actions often need to be taken on an ad-hoc basis and rationalizing all decisions would lead to a number of lost opportunities. Moreover, as the world is more and more complex, one person cannot possess all the necessary knowledge and we rely on the successful collaboration of various experts. It is often women who have the competencies to reunite diverse personalities and facilitate constructive cooperation. On a company level, the overall client experience will only be positive, if internal collaboration works and employees are involved and satisfied.

#### YOURSELF

**Q: What do you see as one of the key factors that brought you to this position today?**

I can say with confidence that the most important factor that brought me to this position is the extensive network that I was able to build, having worked in various positions of the company throughout my career. **Especially in a little country such as Luxembourg, it is crucial to build on existing local knowledge while leveraging the expertise of the company's international network.** SGBT represents around 10 percent of Société Générale's revenues. This is a considerable sum, however, what makes

it even more interesting is the sum of the various *métiers* at SGBT and the ability to create synergies between them. SGBT Luxembourg might not be the most important branch when analyzed *métier* by *métier* but it is the sum of the parts that creates a bigger whole. This needs to be explained to the group which tends to make a clear split between their different service lines. My ability to communicate our way of functioning to the network and my role as an "ambassador" for Luxembourg enables us to receive the support that we need from the group in order to develop.

**Q: Any advice for aspiring leaders, particularly for aspiring women leaders?**

The first advice would be to develop an extensive network throughout your career. As I described in the previous question, this is what brought me to where I am now and what still enables me to promote a collaborative environment between the various entities of the group. Having a network behind you provides you with visibility and gives you enormous opportunities for your own personal development. Secondly, and this is not any less important, you should not be scared of selling yourself—and this is especially the case for women. Only daring and giving things a try will enable you to develop all those competencies that leaders of tomorrow need to master today.



# Truths and consequences

## Four drivers of change that threaten business as usual



**Andrew Blau**  
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There are four new “truths” of the marketplace that are shaping the future of business. Visible all around us yet rarely considered as a group, they are powering waves of innovation coursing through every sector.

As their impacts spread, they are lowering barriers to entry, unlocking opportunities, and increasing the likelihood of new competition—and business model disruption—for incumbent firms. Could yours be next?

You know the world is changing—globalization, shifting regulatory requirements, and the emergence of cryptocurrencies are just a few of the developments and trends that the financial services industry has seen. Certainly, there is no lack of information on trends that are shaping the marketplace.

But what if you could see some of the longer term patterns behind the day-to-day events that are covered in the business press—the *how* and the *why* behind these trends and developments?

Then you would have a leg up on the key leadership challenge memorably stated by the German philosopher Arthur Schopenhauer: *“The task is not so much to see what no one yet has seen, but to think what nobody yet has thought about that which everybody sees.”*

Even better, it could help you respond more effectively to an ever-changing world. Viewing these trends and strategic risks through a different lens can help you draw more powerful and useful conclusions and—it is hoped—help you manage threats not just to day-to-day operations, but the even more dangerous threats that can potentially disrupt your organization’s business model.





## TRUTH #1: *Coordination has never been easier*

Getting more than just a few people to coordinate their actions used to be hard. Huge amounts of human energy and inventiveness went into figuring out how to coordinate groups. But now there are hundreds of applications that put people in touch with one another. Social media outlets have already infiltrated our daily lives, but there is another wave of game-changing platforms like Whatsapp, Viber, Dropbox and Reddit that is improving communication and coordination globally.

When coordination gets easier, people can better share and develop products, services, research, ideas, and opinions. As a result, organizations can form without traditional obstacles, creating new business models in the process. Teams can be built around a shared purpose, drawing the right talent from a global pool rather than settling on talent that is locally available. Small groups and individuals can achieve coordinated outcomes that used to be possible only for large organizations.

## Four truths in a changing world

In the work we have done with clients across a range of industries, including financial services, we have seen four new features of the world that are game changers for business and innovation. These four truths are making what was once difficult, expensive or complex now easy, cheap, and simple.



## TRUTH #2: *Money has never been easier*

Making money is still difficult. But the world's money supply, estimated to be approximately US\$60 trillion, is almost all natively digital,<sup>1</sup> which means that aggregating, organizing, moving, and exchanging money has all gotten much easier. The result is tremendous power and freedom for handling money without dependence on traditional institutions.

Thanks to organizations like Kickstarter, inventors can present new ideas and raise start-up capital to launch new ventures without relying on traditional investors and lending institutions. We are now even seeing crowdfunding models for real-estate investing, scientific research and angel investing.<sup>2</sup>

A testament to the transformative power that both coordination and money sharing has had can be found in Lending Club, an online peer-to-peer lending platform that facilitates loans by connecting borrowers and lenders. Lending Club is able to offer borrowers lower rates on loans and investors higher return rates by bypassing the established banking system.<sup>3</sup> In the eight years since its inception, Lending Club has facilitated over US\$7 billion in loans and has plans to continue expanding across the credit industry.<sup>4,5</sup>

With mobile phones, widespread cellular data and internet access, sending money is also easier. Applications such as Venmo, PayPal, CoinFling and Square give small businesses and individuals the ability to collect multiple forms of payment and send money across great distances, at a fraction of the cost and inconvenience of similar transactions 10 years ago.

Funding ecosystems are also now more diversified and increasingly flexible. As Gideon Lewis-Kraus observed in a *Wired* magazine story about Silicon Valley start-ups, "it has never been easier to raise a small amount of money. And it has never been easier to build a company—especially a web or mobile product—from that small amount of money"<sup>6</sup> (which we will turn to next).



### TRUTH #3: *Making has never been easier*

Making things—from small batch prototypes to mass production of complex objects—has already gone through a step change in ease and sophistication. And access to increasingly sophisticated machinery is seemingly everywhere. TechShop, as one example, is bringing such technologies as 3D printers, CAD/CAM software, and laser cutters to designers and inventors all over the United States (and soon in Europe as well).<sup>7</sup>

Going beyond physical products and services, software and networks help create new financial products and services that not long ago would have been impractical or even impossible to create in-house. As David Goldman of Revolution Ventures told *The New York Times* earlier this year, “We estimated that it costs 10 percent what it cost even 10 years ago to start a software company.”<sup>8</sup> One result is the emergence of technology-enabled financial start-ups, or “fintechs.” In 2014 alone, investment in fintech start-ups reached US\$6.8 billion.<sup>9</sup>

One such fintech is MetroMile. Using widely available Global Positioning System (GPS) technology, MetroMile created pay-per-mile insurance coverage for low-mileage drivers who often overpay for insurance and for subsidized high-mileage drivers who tend to have more claims. MetroMile has also begun offering insurances for car services, such as Uber.<sup>10</sup> Driver mileage is measured through a GPS-enabled device that plugs into the car’s diagnostic port and transmits data via cellular data networks in real time.<sup>11</sup> The creation of this new business actually took just a handful of people: *The New York Times* reported that MetroMile launched and went to market with only 15 employees.<sup>12</sup>



### TRUTH #4: *Learning has never been easier*

Finally, the ability for anyone to learn has been transformed. The capacity to access and discover information from peers, standing bodies of knowledge, and observations of what is happening as it happens is fundamentally new, especially at the scale we see it now. Furthermore, the access to learning is largely free.

Want to learn a new skill? Organizations from Khan Academy to EdX to thousands of videos on YouTube help people learn new things. Want to supplement your education with advanced lessons from some of the world’s most prestigious universities? Many are putting free courses online. Access to experts is available quickly, easily and affordably on Quora and Ask.com, to name but two.

Specific to financial services, traders can access freely available recommendations via such sharing platforms as Nvest, an early stage crowdsourced stock recommendation platform. Anyone can submit stock recommendations, which are then compiled by Nvest. Contributors’ performance histories are also tracked to assign credibility scores to those recommendations.<sup>13</sup> In addition, analytical processing and modeling capabilities, which were once available to only the largest companies, can now be accessed through cloud platforms.





### From the four truths to the three V's

These four truths are already here, and nothing seems likely to slow their growth or reach, much less reverse them. The consequences could play out for a generation or more.

We are already seeing that the number of start-ups around the world is growing, and the rate at which new entrants are coming to market is increasing. Again, the impact of the four truths is that fundamental tasks for organizations that used to be hard are being made easier. So finding the right talent and collaborating over long distances has been simplified. Complex products can be created through collaboration with subject

matter experts. And digitized information is ubiquitous and available literally at your fingertips. All of this is compounded by the relative ease with which we can move and manage money.

As a result, the three V's—volume, variety and velocity—of new business formation are growing, and we expect they will grow more. The traditional business models that were defined by limitations in coordination and access to technology, knowledge and capital are no longer the only viable options. New technology-enabled businesses are free to experiment with structures that are smaller, nimbler, and cheaper to operate.

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## We are already seeing that the number of start-ups around the world is growing, and the rate at which new entrants are coming to market is increasing

### New types of organizations are emerging

It is no surprise, then, that new types of organizations are emerging—organizations that are established not over multiple generations, but that can emerge and grow to dominance within a decade. As we witness new companies developing at exponential rates, we are also seeing the accelerated pace at which long-established organizations stumble when faced with disruption: top automakers go bankrupt; leading retailers collapse; and the most prestigious names in news struggle against the relentless erosion of their businesses, to take just three recent examples.

In short, a new generation of businesses is forming around these trends. In the book, *Exponential Organizations*, authors Salim Ismail, Michael S. Malone, and Yuri van Geest introduce the concept of an “exponential organization,” or ExO, and define it as an organization “... whose impact is disproportionately large—at least 10x larger, compared to its peers because of the use of new organizational techniques that leverage accelerating technologies.”<sup>14</sup>

We often think of companies that experience explosive growth in the context of start-ups. But existing companies can also take advantage of these truths to enhance internal operations. *Exponential Organizations* highlights the example of ING Direct Canada and its transformation into an ExO. Established in 1997, ING Direct Canada was an experiment in branchless banking for its parent, ING Group.<sup>15</sup> ING Direct’s business model depended on customer satisfaction and the development of coordination technologies: phone, internet, and now mobile applications. It also eliminated the costs associated with running brick-and-mortar branches and diverted resources to creating services tailored to the consumer.

Without the branch network, ING Direct Canada, which was renamed Tangerine in 2013,<sup>16</sup> proceeded to engage with customers in different ways and focus on creating award-winning products.<sup>17</sup> Tangerine now enjoys a customer-to-employee ratio that is seven times higher than the average Canadian bank (1,800 customers per employee) and total deposits per employee that are four times higher than average (US\$40,000 per employee).<sup>18</sup>

Or consider the New York Stock Exchange (NYSE), which in 2011 launched its NYSE Technologies’ Cloud Platform, which offers a range of on-demand, cloud-based services—including Infrastructure as a Service (IaaS), Software as a Service (SaaS), and Platform-as-a-Service (PaaS). The NYSE community uses this platform to purchase the computing power needed for operations and to refocus resources to core business strategies.<sup>19</sup> This product helped NYSE Technologies, which was acquired by Intercontinental Exchange in 2012, to capitalize on the growing trend of automated trades and the value of server colocation. It also created a way for NYSE to broaden its brand as a “human run operation” and to be considered a “technology-enabled institution.”

With technology-enabled organizations entering the marketplace with unprecedented velocity, variety, and volume, the traditional notion of ally and competitor is being brought into question. Competing institutions often have similar needs in terms of talent, capital, and IT infrastructure. Also, if the recent cyber-attacks on international financial institutions have taught us anything, it is that many financial services institutions have similar vulnerabilities in cybersecurity and can benefit from collaboration over common strategic risks.

### Responding to this new reality

As you consider the four truths, the changes already seen in business and society, and the changes that are yet to come, you may be asking: What now? Or, more specifically, how can you respond to changes and events that are uncertain, have no historical precedent, and leave an organization vulnerable to strategic risks that threaten to disrupt the assumptions at the very core of its business model?

It is impossible to know the future for sure. But we do know that past decision-making practices cannot simply be retrofitted to a new set of problems. From a risk-management standpoint, strategic risks pose challenges because of their complexities and potentially high stakes. Therefore, new approaches to manage those strategic risks are needed.

Fortunately, the tools to help companies survive in a changing world do exist. Smart organizations will develop a system to deal with unexpected change that threatens their business models.

This system should include people, processes and capabilities to:

1

#### Accelerate discovery

The option to remain on autopilot after deciding on a strategy is no longer sustainable. Instead, today's organizations must institute mechanisms that accelerate discovery at a pace that can keep track of surprises and revisit strategies if they are no longer valid.

2

#### Scan ruthlessly

Identifying sources of risks is the first step to preventing surprises. The next step is to continuously track those risks as they develop. Leveraging expert partners for trend analysis and future scanning can surface subtle indicators of change that could add up over time to produce a tipping point.

3

#### Confront biases

What you have experienced in the past will not likely repeat itself. We have to challenge our understanding of our operating environment in order to embrace necessary change that can initially be disorienting and uncomfortable.

4

#### Prepare for surprise

After understanding your potential risks, it is important to rehearse readiness. Decisive action in the face of ambiguity is one of the greatest challenges of leadership. Establishing thresholds and courses of action in various futures can help to prepare for an uncertain one.

Strategic risks can destroy huge amounts of value very quickly, and they can threaten the existence of the institution or entire lines of business. Identifying these potential risks early can only be to an organization's advantage. As Pierre Curie said, "fortune favors the well prepared mind." Fortune should also favor those organizations that consider the changes now and explore, systematically and as ruthlessly as possible, not only the business model risks they pose, but also the opportunities they present.



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# Cross-border business considerations in the private banking and wealth management industries

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Given the size of the country, Luxembourg's financial services industry is based mainly on cross-border business. The wealth management and private banking industries are no exception as the local players' clientele stands in increasingly distant places such as the Middle East, Latin America, or Asia.



The pressure for global tax transparency and regulatory compliance—especially in Europe—has caused a significant shift from offshore to onshore wealth. For instance, over the last couple of years, hundreds of affluent individuals living in Luxembourg’s neighboring countries have made the choice to transfer their assets to their country of residence in order to avoid any potential conflict with their local governments. Interestingly, during this process of “onshorization”, some Luxembourg banks and Family Offices (FO) have made the bold choice to set up a branch abroad in order to follow their clients in their country of residence rather than losing them to the local competition. These affluent customers would then carry on benefiting from Luxembourg’s excellence in financial engineering and access to a wider range of investment vehicles.

However, the increasingly protectionist measures from governments in Europe should not lead us to forget that free movement of goods, people, capital and services within the EU—including financial services—is a fundamental right laid down in the Treaty on the Functioning of the European Union (TFEU). These “Four Freedoms” remain the cornerstones of the internal market. This is very important to remember, especially for the tax and regulatory compliant (U)HNWI and wealthy entrepreneurs whose business activities are usually global with assets and family members split in different countries (e.g., children residing or studying abroad). **These clients, who are in essence mobile and travel the world, usually like to be served, wherever they may be, by the same trusted advisers.**

In Europe, the “Free Provision of Services” (FPS) principle applies to wealth managers and private bankers crossing borders to serve their clients abroad. This principle allows Customer Relationship Managers (CRMs) of a European entity to meet or serve their client in another country, even when the financial institution does not have a permanent establishment locally.

However, **European governments increasingly impose stricter rules to the general European FPS principle.** CRMs should be permanently aware of the latest regulatory and tax developments not only in their home country, but also in their clients’ country of residence. As a consequence, private banks and wealth management firms should rethink their cross-border operating model and may now more than ever take advantage of digital and mobile solutions in order to avoid any non-compliance issues which may impact their business and reputation.

#### **Increased regulatory requirements**

In the aftermath of the financial crisis, the regulatory pressure on the wealth management and private banking industries has increased. Regulatory frameworks such as national regulations on consumer protection, the Foreign Account Tax Compliance Act (FATCA) and investor protection rules including MiFID have an impact on the cross-border banking operating business model, and affect its efficiency and profitability. Observations show that the cross-border banking operating model remains unchanged despite the changes in the local and international regulatory frameworks. This approach can lead to significant risks of non-compliance.

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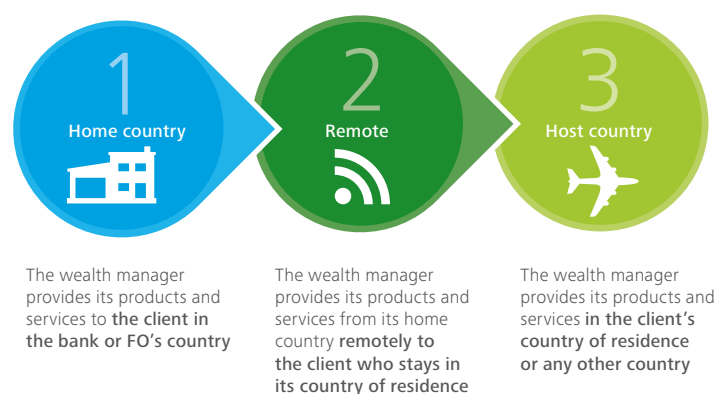
## These clients, who are in essence mobile and travel the world, usually like to be served, wherever they may be, by the same trusted advisers

### Cross-border private banking considerations

The EU free movements law is about the free movement between Member States, and its application therefore requires the existence of a cross-border element. It is considered that there is a cross-border element as soon as the service provider and the service recipient are not located within the same Member State. In the case of the free movement of services, it used to imply that either the service recipient or the service provider had to travel to another Member State. Since the development of internet and other distance communication tools, it is however now also possible for the service to travel directly between Member States.

In practice, private banks intending to prospect new—or serve existing—customers abroad may either set up a branch in the client's country of residence or may provide services across borders remotely or by allowing CRMs to travel to the client's country of residence. While in Europe, the EU CRMs benefit from the freedom of provision of service, this principle does not apply beyond the 28 EU countries. The benefit of the freedom to provide services within the EU will ease the cross-border provision of services, but local differences remain. The local regulations may prevail and differ from one country to the other. Some national supervisory authorities require foreign private banks to set up a local branch or subsidiary to carry out business on their territory.

Cross-border business may be carried out actively or passively depending on the origination of the business relationship. A CRM would typically start an active cross-border business relationship when intentionally contacting a client remotely by phone or email or meeting in person abroad.



The CRM would passively carry out a cross-border business activity when a client initiates the business relationship by contacting the banker. While in some countries this so-called “reverse solicitation” principle may allow for more flexibility in serving a potential customer, providing evidence of passive contact may prove challenging.

Finally, an important element of cross-border private banking is the location of the provision of service. The main client groups concerned by cross-border banking are the (U)HNWI and wealthy entrepreneurs carrying out business globally. Four distinct cross-border situations may occur and involve taking into account one or more different legal, tax and regulatory frameworks. Indeed, cross-border business is usually understood as a CRM travelling to his client's country of residence to meet in person and develop a business relationship. However, as these customers are highly mobile, the contact with the bank's CRM may occur in person at the bank's head office. Contact may also be made by the CRM remotely from his office with distance communication tools including email, mail or telephone (e.g. cold-calling prospects). Finally, a CRM who may want to meet his client in the bank's foreign branch may put his employer at risk as the foreign authorities may consider the contract to have been signed in a permanent establishment (the branch) and therefore should be governed by its foreign laws and regulations. In addition, the CRM may consequently be considered as an employee of the foreign branch and be taxed under the foreign tax regime.

All these different aspects of cross-border banking are crucial since they dictate which supervisory scheme and local regulations apply.

### EU passport

Article 56 TFEU prohibits Member States from restricting the provision of services within the EU. This right has been implemented through various secondary EU legislations, the most important in terms of financial services today being the Directive 2004/39/EC and the Directive 2013/36/EU, which respectively define the access to the "EU passport" for investment firms and credit institutions.

This EU passport grants credit institutions and investment firms established in a Member State the right to provide services within the EU either with the establishment of a branch or through the direct "Free Provision of Services" (FPS). This passport and the

relevant Directives significantly eases the cross-border provision of services through a partial harmonization of the relevant law (standards fixed at the EU level) and the application of the legal framework of the Home Member State in key areas (for example in terms of authorization), at the exclusion of the legislation in the Host Member State. The scope of this Home Member State control will typically be wider in case of FPS, as there is no establishment in the Host Member State.

In case the relevant rules have not yet been harmonized and the Home country control principle does not apply, the Directives require Member States to guarantee the access to the service activity and the freedom to exercise such activity throughout the territory. The Treaty also generally forbids Member States from restricting the free movement by imposing their national requirements on cross-border service providers unless the Member State can demonstrate that the measure is necessary to ensure the respect of one of the limited justifications allowed and that the measure is proportionate. In 2013, the ECJ stated that combating money laundering and terrorist financing constitutes a mandatory requirement justifying restrictions on free movement of services<sup>1</sup>.

### Risks related to cross-border business

The regulatory environment affecting the cross-border provision of financial services has increased in recent years, and as a result threatened the continued existence of certain institutions. G20 governments recently signed an agreement to deter cross-border tax evasion. The agreement required governments to share information and cooperate in audits to detect companies and customers attempting to evade taxes.

This growing trend of regulatory requirements reinforces the need of private banks and wealth management firms to review their compliance procedures and adapt their cross-border operating model to reduce regulatory risk and protect their clients' interests.

<sup>1</sup> *Jyske Bank Gibraltar – Case C-212/11*: "EU law does not preclude Spanish legislation which requires credit institutions, operating in Spain without being established there, to forward directly to the Spanish authorities information necessary for combatting money laundering and terrorist financing"



Cross-border regulations also have a big influence on private banks' business models. Cross-border regulations include national rules governing the sale of financial services, which includes marketing, consumer protection, distance selling, and financial advice to consumers. These regulations vary from country to country, which adds to the already complex regulatory environment.

This complex regulatory environment and the differences between countries mean that banks have to adapt their products and customers due diligence frameworks, which should take into account the specific regulatory requirements of the client's country of residence. This causes a further increase in operating costs, with a direct impact on the industry's profitability.

### Looking ahead

Mitigating the regulatory risks associated with cross-border banking services is complex but essential in order for players to remain competitive. The complexity of cross-border business activities stems from the individual country requirements concerning investment suitability, cross-border regulation and tax transparency. The complexities of the regulation as well as the differences from country to country are the main risks that should be mitigated.

One solution is to increase the awareness of CRMs in this specific field, as they are the ones who cross the borders and who put their bank's image and reputation forward on a daily basis. However, as CRMs are highly mobile, the regulatory compliance should be as well.

Country-specific regulatory knowledge solutions should provide clear instructions to CRMs about the permissible services and products under national and international regulations. The solutions should be tailored in line with the banks' business development policies, as each financial institution will approach customers in a specific way.

The cross-border business regulatory awareness solution should ideally be digital and easily portable, as CRMs do not always have the opportunity to prepare for a client meeting from their office's desktop but rather prepare "on the go".

Last but not least, one should not forget that regulatory compliance is only one angle of cross-border private banking and wealth management; cross-border tax issues and compliance should also be taken into account in order to adequately serve customers.



# Capturing value in a shifting environment

## Path to value for wealth management centers

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The international private wealth management industry has come successfully through the global financial crisis and the subsequent challenges of weak national economies and increased regulatory activity.







Financial markets have enjoyed rapid growth, boosting private wealth; and expansionary monetary policies and evolving emerging markets have helped wealth managers to increase their client asset volume. Nevertheless, providers are facing challenges linked to falling revenues and profit margins in their cross-border business.

Wealth management centers are not all impacted the same way by the new trends on the market resulting from this changing environment. The best opportunities for attracting new client assets—a critical factor for any wealth manager—are currently found outside Europe, in emerging economies, mainly in Asia, where there is strong growth in consumer disposable income and wealth creation.

In spite of certain positive developments, providers of wealth management services still need to address the challenges in their cross-border business and therefore must look for new strategies to enhance their performance. Not all wealth managers are facing the same challenges and have equivalent areas of interest: they must understand the specific needs of their respective clients to undertake an efficient path to value.

#### **Performance of key international Wealth Management (WM) centers from 2008 to 2014**

##### **Growth trends highlight emergence of Asian WM centers and resilience of large European centers**

The period 2008-2014 can be divided into two phases. The period from 2008-2012 saw the rebound from the financial crisis and the subsequent euro crisis, while 2012-2014 was a period of tightening regulations.

“Winning” wealth management centers exhibited positive International Market Volume (IMV) growth in both sub-periods. “Stagnating” wealth management centers experienced an increase in IMVs in the period 2008-2012, followed by a decline between 2012 and 2014. “Struggling” wealth management centers lost IMV in both sub-periods, and “catching up” centers grew their IMV from 2012 after a decline in 2008-2012.

Hong Kong ranks first in terms of (relative) asset growth in the period (+142 percent), followed by the United States (+28 percent), Singapore (+25 percent), Switzerland (+14 percent) and the United Kingdom (+13 percent). Switzerland and the United Kingdom experienced a rather unsatisfactory period between 2012 and 2014, but increased their IMV between 2008



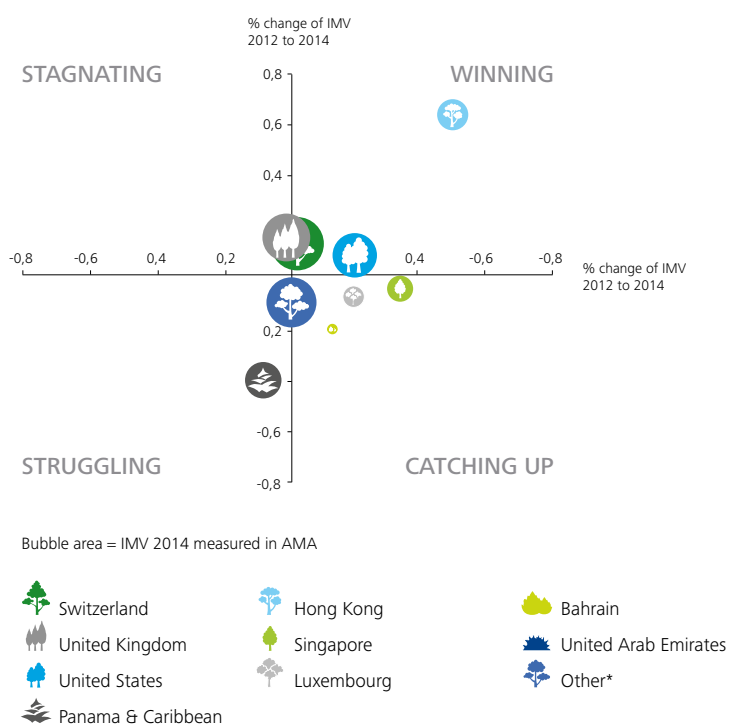
and 2012. Therefore, both centers are positioned on the borderline between the winning and stagnating quadrants. Panama & the Caribbean lost a substantial amount of market share to the United States. Other European centers, excluding Luxembourg, did not quite manage to catch up although they avoided further IMV losses between 2012 and 2014 after a decline of 12 percent between 2008 and 2012.

These findings suggest that European centers suffered from the combined effect of two developments:

- The first one is the euro crisis culminating in 2012, which affected FX performance and led private clients to revisit their strategy of placing assets in international wealth management centers in Europe
- The second one is linked to the tightening of regulations in 2013 and 2014, such as MiFID II, tax transparency, FATCA, and banks' efforts to regularize their client assets

**Strong market performance compensates for negative Net New Assets (NNA) trend**

**Figure 1. Growth in international market volume 2008 – 2012 and 2012 – 2014**



\* Other: Austria, Belgium, Channel Islands, Germany, Ireland, Liechtenstein, Monaco  
Source: Deloitte Wealth Management Database

## Good performance of financial markets is key to understand competitiveness by market volumes

### *Negative NNA*

Separating IMV growth in the period 2008-2014 between Net New Asset (NNA) flows and the effects of capital market performance and foreign exchange rates reveals that most centers are struggling to attract net new assets. In total across all wealth management centers, 2012 was the only year between 2009 and 2014 when there was an increase in net new assets (US\$72 billion).

Hong Kong was the strongest performer amongst wealth management centers in terms of cumulated IMVs, and apart from Singapore, it was the only center with positive cumulative NNA between 2009 and 2014 (US\$285 billion in total, representing an increase of 108 percent in relation to IMV as at the end of 2008). The two leading wealth management centers in terms of total client assets, Switzerland and the United Kingdom, experienced a cumulative outflow in the same period of US\$135 billion and US\$300 billion respectively. The biggest NNA reductions against 2008 IMV were in







Bahrain (39 percent reduction), the United Arab Emirates (43 percent) and Panama & the Caribbean (75 percent).

Overall, the majority of wealth management centers experienced negative cumulative NNA relative to IMVs in 2008: the falls ranged between one percent for the United States and 75 percent for Panama & the Caribbean.

### *Overall competitiveness by market volumes*

Overall IMV increased from US\$9.0 trillion in 2008 to US\$9.2 trillion Assets under Management and Administration (AMA) in 2014. This increase of US\$0.2 trillion—or 2.2 percent—was driven by economic growth, positive capital market performance, and an increase in the number of millionaires; but it was also affected by repatriation and regularization of client assets. Various elements explain the observed trends. First, good performance of financial markets is key to understand competitiveness by market volumes.

**Figure 2. International private client market volume in the leading wealth management centers (in US\$ trillion)**

Ranking	Wealth management center	AMA at the end of 2014	Variation in AMA since 2008
1	 Switzerland	2.0	14%
2	 United Kingdom	1.7	14%
3	 United States	1.4	28%
4	 Panama & the Caribbean	0.9	-50%
5	 Hong Kong	0.6	146%
6	 Singapore	0.5	24%





There was a rise in the major financial market indices; the MSCI World Index (in US\$) rose by 85.8 percent and the Barclays World Government Bond Index (in US\$) increased by 28.5 percent. A key driver for the boost in financial market performance was the expansionary monetary policies of central banks.

Second, economic growth is another explanation for the observed trend. Partially due to the intervention of central banks, global GDP grew by 20.5 percent between 2008 and 2013 with a projected further increase of 3.3 percent in 2014. However, the rate of economic growth was not consistent across the globe. While East Asia and the Pacific, Switzerland and the United States experienced positive economic growth, GDP in the European Union fell by 5.6 percent, and this trend is expected to continue.

Third, the number of millionaires increased over the last few years. Accelerating economic growth in many developing countries boosted private wealth. According to the World Wealth Report, the number of High Net Worth Individuals (HNWI) grew from 8.6 million in 2008 to 13.7 million in 2013 (an increase of 59.3 percent).

#### **Trend to onshore continues**

While global wealth is increasing, IMV booked in leading international wealth management centers is growing at a slower rate. This indicates that private clients have withdrawn assets from their international accounts and also booked newly generated wealth with domestic wealth managers.

We observe a global trend of assets repatriation.

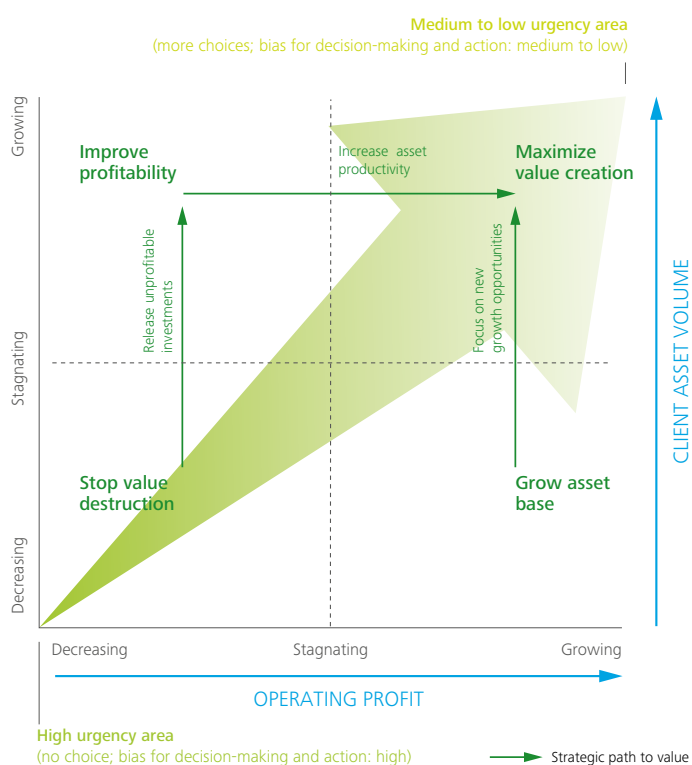
The result of the international pressure to lift banking secrecy is the loss of privacy, which particularly impacted Switzerland, Liechtenstein and Luxembourg. The retrospective reinterpretation of applicable law lowered the trust of clients in stable legal environments. Furthermore, the negative press coverage of international banking issues damaged the reputation of wealth managers globally. In response to the loss of privacy, the reduction in the level of legal certainty and reputational damage to some wealth management centers, a number of international clients decided to repatriate their wealth. In consequence, international wealth managers have started to revisit their business models and are withdrawing from certain countries and/or client segments. This is forcing an increasing number of clients to seek alternatives, such as returning to domestic wealth managers.

In some cases, private individuals have been penalized as part of the regularization process, affecting some of their assets. These regularizations have mainly been the result of a treaty between their country of domicile and the resident country of their wealth manager or part of a lawsuit initiated by their home country's administration.

In response to increasing regulatory pressure - and to avoid prosecution - some clients have transferred their wealth from bank balances to non-bank assets (such as real estate and investments in artwork or watches).

A review of strategic choices can lead private wealth management companies to find the right approach in today's complex conditions and continually evolving business environment

Figure 3. Path to value map for international private wealth management



#### Paths to value: the case for exploring other strategic choices

International market players face the challenge of restoring strong growth in their business as well as increasing their profitability, by improving their operational performance and attracting new client assets. In order to find their path to value, some strategic changes may be necessary. However, not all wealth management services providers need the same agenda for change. They must first assess their current position, and then target an end point on the path to value by defining goals for business performance improvement.

A two-dimensional framework combining client asset volume and operating profit can be a base to identify four generic strategies, which should be chosen according to the issues faced by each wealth manager:

- **Stop value destruction:** revealed by falling client asset growth rate combined with a shrinking profit margin
- **Improve profitability:** licensed wealth managers face the challenge of a positive client asset growth rate but a declining operating profit margin
- **Grow asset base:** some private banking service providers have a favorable operating profit margin but a declining client asset base
- **Maximize value creation:** wealth managers register growth in both client assets and operating profit margin

By applying this framework over a three-year time horizon, three different paths to value can be identified, as set out in the following table.

**Figure 4. Strategic choices for value creation**



The interests of shareholders and management play a role in determining which path to value a wealth management provider should pursue, as shareholder interests include their financial needs and objectives, risk tolerance, whilst also retaining financial and operational control themselves.

Rigorous qualitative and quantitative analysis of the current situation, potential strategic choices and their impacts on business/operating, tax and capital model, is essential. A review of strategic choices can lead private wealth management companies to find the right approach in today's complex conditions and continually evolving business environment.

## Conclusion

Overall, the growth in IMV of international wealth management centers has not matched the strong performance of the financial markets or global economic development over the period 2008-2014. The analysis of net new assets acquisition reveals that most centers are struggling to attract new client assets: 2012 was the only year in the period 2008-2014 with positive NNA. However, not all wealth management centers are suffering.

These findings clearly show that the international wealth management industry is undergoing unprecedented changes due to growing regulatory pressures and increased scrutiny on tax transparency. This has led to a regularization of assets, their repatriation as well as the exchange into non-bankable assets.

To address these challenges, it is ever more important for wealth management service providers to identify a tailored strategy that will drive improvements in productivity and business performance. Furthermore, competition has intensified. Even for leading centers with a strong reputation, client relationship management and discretion are no longer sufficient for success in today's international wealth management market. The main levers are releasing unprofitable investments, increasing client asset productivity and focusing on new growth opportunities.

Hence, wealth management providers need to balance those levers to ensure long-term profitable growth and face the macroeconomic trends.





# Wealth management and private banking Connecting with clients and reinventing the value proposition

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The wealth management and private banking industries have changed significantly over the past few years.

Increased regulation and tax transparency requirements in the aftermath of the financial crisis have caused a significant shift from offshore to onshore wealth management. Moreover, emerging market players are targeting developed markets while developed market players are seeking growth outside of their home markets.

In this context, many wealth managers and private banks have optimized their operating models. Nonetheless, we believe that the industry has yet to address the challenge of redefining the complete spectrum of value propositions made to clients, and how value is delivered to clients through a combination of products and services, channels and pricing. To explore this avenue, we have conducted a survey to assess how industry players in Europe and internationally are reinventing their value propositions.



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## Overall, known challenges persist but the need to reinvent value propositions is high up on the strategic agenda

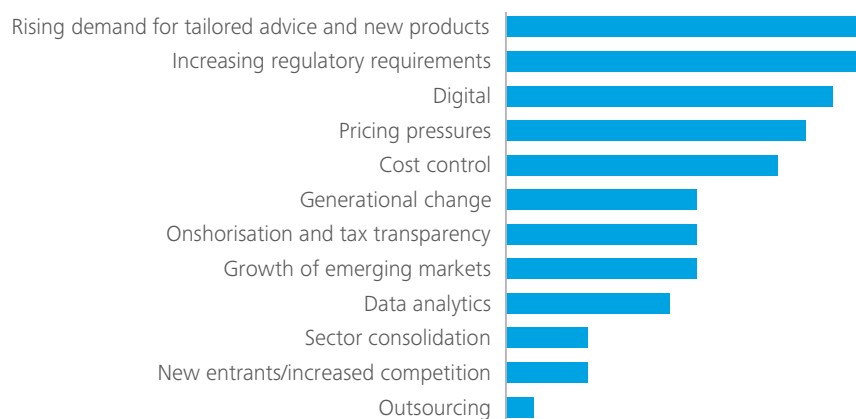
This survey confirms that the wealth management and private banking industries continue to experience profound economic, regulatory and technological changes and there is continued pressure on industry players to revisit their business models and client value propositions. These “usual suspects” coupled with the increasing attention on cost control and rising demand for tailored advice are still at the top of the agenda for the industry.

In Europe, we have observed two different models emerging in the last few years since the financial crisis. Some firms, in particular the large international banks (e.g. U.S., UK, French and Swiss banks) but also regional champions, are focusing on achieving scale and the development of a strong integrated banking offering, which combines traditional wealth management with loans, banking and other services enabled by a bank infrastructure. In parallel, other players are focusing on pure-play wealth management, placing increased emphasis on the relationship aspects of their business, focusing on providing client-centric solutions and high quality advice through the selection and use of multiple third party solutions. In parallel, defining how to expand or refocus the geographic footprint is an important consideration to balance against soft volume trends in home markets.

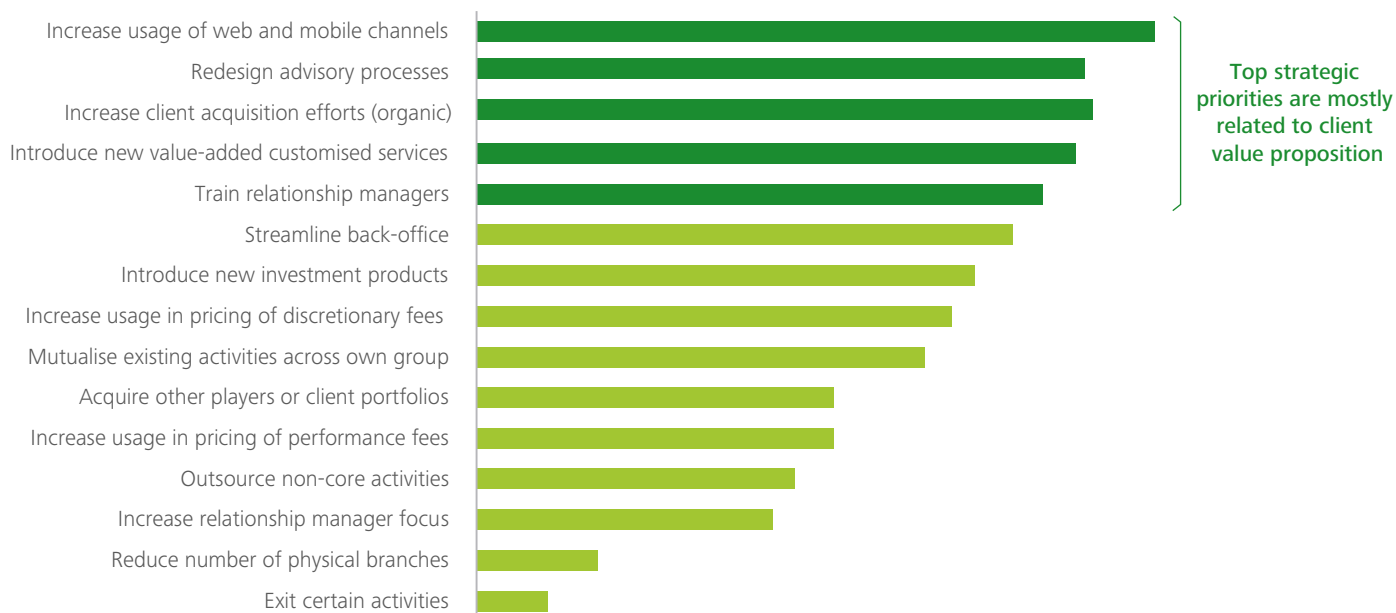
The survey also confirms that improving the value proposition offered to clients is among the top strategic issues for the next few years. In fact, several stated priorities by respondents relate to front activities impacting the core value proposition offered to clients, as opposed to just cutting costs or seeking external growth. In particular, the digital transition and the redesign of the advisory function and the introduction of tailor-made services are key considerations. As this next wave of change comes about, industry players should position themselves around those dimensions, for example, using digital channels beyond transaction execution and consultation to deliver advice.



### Top trends affecting your institution



### The priorities for your institution's strategy in the next five years





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## Advisory models need to evolve to reflect increasingly sophisticated client needs and bring more added value to clients

Client needs are evolving and the need for more tailored advice is increasing. Our survey confirms that the core services of providing wealth management advice and managing client portfolios need to be reinvented. The traditional model where the wealth manager makes most decisions related to the client's account is changing.

We see an increasing evolution toward advisory models where the wealth manager and the client work together, which in turn brings implications in terms of transparency, reporting and accountability. In other words, enabling self-management and allowing clients to play an active role in managing their wealth is becoming increasingly important. As investors are becoming more financially knowledgeable and tend to actively manage at least part of their assets, wealth managers are expected to provide advice and the necessary infrastructure to carry out their investments. For this model, ensuring clear and full accountability and communication with the client is key.

Next to this, we note that client expectations across segments tend to become more sophisticated and that fully standardized offerings and product-centric approaches are no longer sufficient to compete

effectively. In other words, the traditional investment product and portfolio management offering itself is not the primary source of differentiation with clients. Instead, understanding clients and their needs at various lifecycle stages, and being able to provide wealth solutions beyond the investment portfolio, is critical. Important solutions in this respect include the ability to offer tax-optimized solutions across geographies and the support to clients in structuring their wealth optimally considering their preferences and lifecycle needs. Other specific services such as tax reclaim can also help deliver immediate value to clients at often limited cost.

Within managed portfolios, we are observing a shift from traditional investment vehicles to customized investment portfolios. While this service used to be accessible mainly for higher-end clients, we now see examples of firms providing tailored services with minimal investment requirements (typically around €100,000 or less).

In the aftermath of the financial crisis, clients are also demanding more transparent products and services. As they become increasingly financially literate and sensitive to financial risk, many clients expect



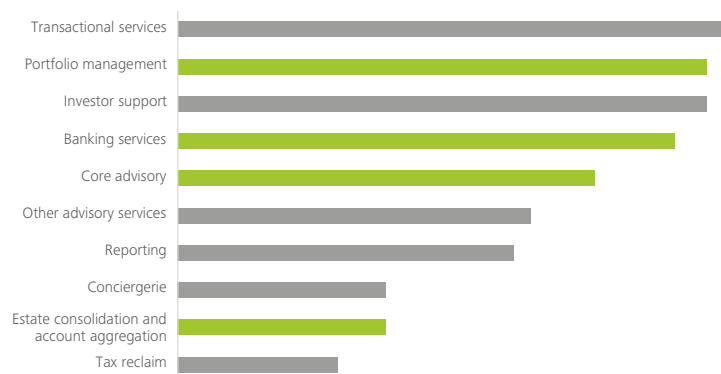
## Industry players need to find new ways to add value through services such as tax optimization, wealth structuring and investor support

transparency to understand the mechanics, risk and reward trade-offs and fee structure of their investments and services. Clients often spread their holdings between providers and have gained access, or at least visibility, on investments which they can access directly with potentially lower fees. As a result, clearly disclosing fees associated with the relationship and the services offered has become a given. In other words, more than ever before, clarity on investment risks and transparency on fees and potential returns is expected from wealth managers. Current regulatory evolutions are also reinforcing this trend toward more transparency, with MiFID II bringing the need to clarify and redesign the distribution fees charged to investors.

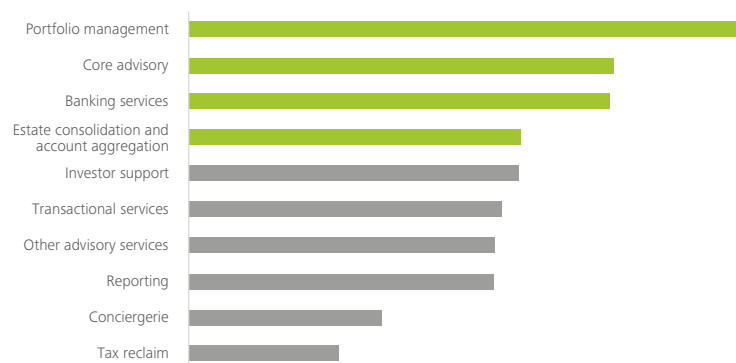
Providing differentiated alternatives for clients to generate investment returns is also important, especially in the current low-yield environment. For example, enabling clients to access broker research and exclusive market insights, or to use the bank's own trading platform directly or to gain exposure to more exclusive investment products (e.g. alternative structures traditionally reserved to UHNWI or institutional investors).

One challenge is to manage the cost of delivering more tailored advice, although typically this can be justified for clients with larger portfolios and with the highest expectations in terms of investment advice. Faced with this challenge, some established players are considering significant business model changes, either going upmarket into pure play, high quality advice, or consolidating their operations across countries to standardize offerings and cut costs. In parallel with this, we see distribution platforms gaining ground in certain markets and expect them to continue developing in the coming years.

### Current product and service offering



### Top contributions to your current product and service offering to further develop your business in the next 5 years





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## Key challenges for digital include integration with existing processes, improvement of the client experience and digital security

### **The digital revolution continues, bringing its own challenges**

This survey confirms that digital is at the top of the wealth manager's agenda. While wealth management has historically been an industry anchored around traditions and face-to-face relationships, clients today are exposed to significant innovation in multiple aspects of their lives outside of the wealth management relationship. Clients see the benefits of this innovation, for example in terms of access to information, convenience to shop and connectivity with other people. From our various discussions, it is clear that the industry is at a stage where the importance of these external trends has been understood, and the call to go digital has been heard. However, the level of players' maturity in the markets surveyed reflects the fact that the path to digital business is not always clear, nor is the implementation and integration with existing infrastructures.

A key challenge we see associated with the digital transition is the need to improve client experience. Today, switching costs are falling due to increased transparency and comparability of wealth management offerings. As a result, client experience is becoming a key differentiator in the market. Addressing this requires players to evaluate all contact points with clients, but also to have a better understanding of clients in order to deliver advice and products tailored to their needs. There is an opportunity for players to shift from a product-centric approach to a more consultative, need-based assessment of relevant client offerings.

A corollary from the digital revolution is cybersecurity and digital archiving. To interact with clients in digital form, it is important to ensure complete immunity against any cyber-attacks or against client data leakage. This becomes even more critical at the high end of the market where an institution's reputation may be impacted significantly by any incident affecting high net worth clients. In light of this, it is our view that ensuring world-class digital infrastructure and security protocols is a fundamental pre-requisite to maintaining a strong reputation and achieving a successful digital transition.

### **Relationships remain central to the model, but now demand multi-channel interactions and advice**

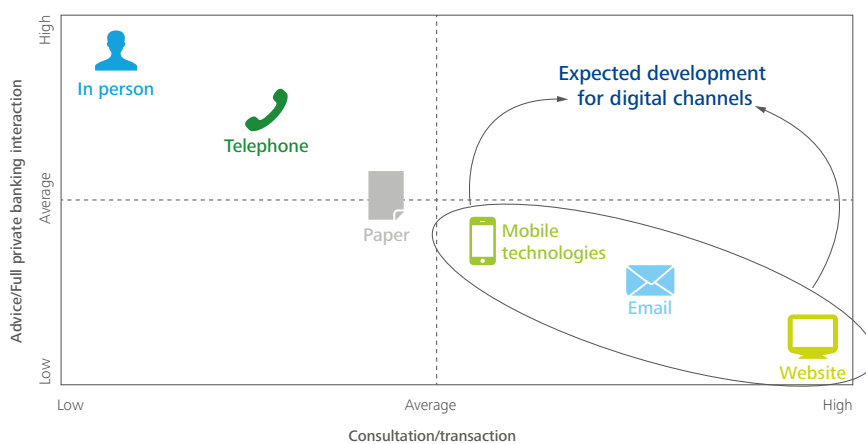
In spite of changing behaviors and evolving technological requirements, and the fact that we see an increasing number of clients preferring direct/online interaction, our survey highlights the fact that maintaining strong interpersonal client relationships remains crucial.

The importance of both relationship and digital aspects highlights the need for multi-channel communications with clients (e.g. telephone, email, mobile, internet, video-conference, Skype, etc.) as a means to provide new services to clients and optimize the mix of "in person" interactions to deliver advice. Digital solutions are perceived and used today to drive convenience and cost-efficiency for execution-only services.

However, we believe combining multi-channel, digital communications with in-person interactions is critical to delivering wealth management advice. Certain players are innovating on these aspects, offering investment ideas and simulation solutions or online access to relationship managers or investment advisers. As digital channels become increasingly important to deliver advice more efficiently, evolving from a consultation and transaction medium to an interactive advisory model with the relationship manager is the key in our view. Nevertheless, the survey confirms that face-to-face meetings remain at the heart of the relationship building and critical when dealing with complex problems or important family events.



### Usage by clients of each interaction channels

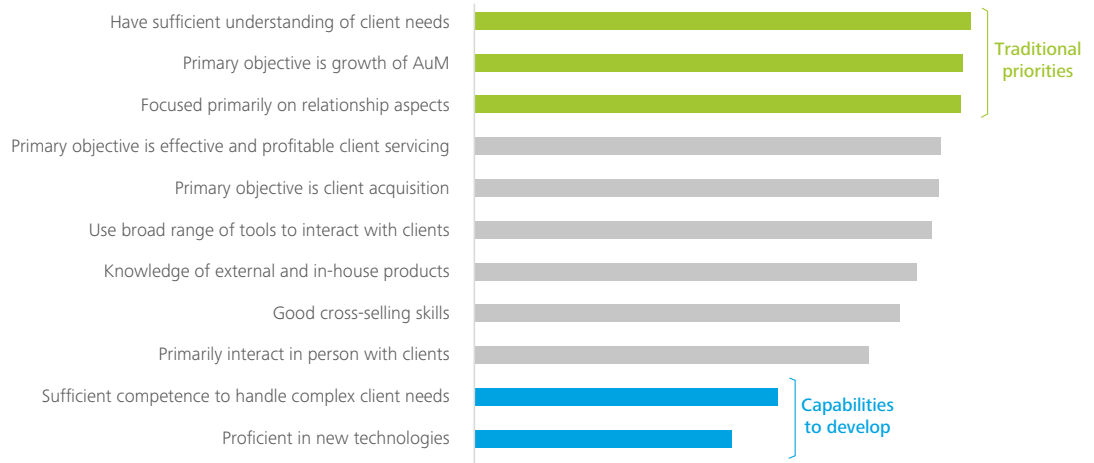


## Relationship managers will need to adapt their expertise and embrace their new role as assemblers of competencies

Achieving this transition will continue to demand strong client-facing capabilities from the relationship manager, but also improvements in the current talent model. The relationship manager needs to be not only “service-oriented” but also have the ability to understand a complex problem and to call upon the right expert or specialist in various disciplines to best serve the client. As the need for more sophisticated advice increases, relationship managers will need more technical wealth engineering expertise to effectively deliver the services proposed by the institution. Relationships will be more service-oriented and less investment product-oriented. Consequently, relationship managers will need to adapt their expertise and embrace their new role as assemblers of competencies.

In other words, the emerging model is one in which relationship managers act as a single point of contact to deliver the various services and offerings of the wealth manager. In this role, the relationship manager acts as an interface between the client and the most relevant services of the wealth manager, whether these are sourced internally or externally. In order to do this effectively, relationship managers need to remain generalists but be sufficiently well-versed in technical aspects to understand client needs which may be diverse, for example in terms of tax, investment products, risk and lifecycle. Organizational and potentially remuneration models also need to be adapted to ensure that all experts and departments are incentivized to work well together to provide clients with a single view and response.

### The current assessment of your relationship managers



## Pricing models should evolve and take into account value perception and behaviors of different clients segments




To ensure these transitions remain economically feasible, industry players will also need to adapt their pricing models. Currently, pricing is still mostly event or transaction-based, and it needs to evolve toward value-based pricing, including advisory fees, integrated models and performance fees. In other words, the quality, value and usage of services delivered need to be translated into pricing, taking into account the needs, value perception and behaviors of different client segments.

While this trend is recognized across the industry, certain players see commercial challenges for the introduction of new advice-based or performance-based fee models. In other markets like the UK and the Netherlands, regulation already encourages specific service-based fees and this trend is already well underway.

We see other challenges in terms of pricing, namely the fact that common market practice continues to put pricing largely at the discretion of relationship managers, albeit with central guidelines. In our view, this tends to reduce transparency and pricing coherence and makes business monitoring, performance management and decision-making more difficult. In fact, we see relatively few banks that have effective tools to monitor clients' profitability or access historical fees charged to their clients. At a time when transparency is gaining more and more importance for clients, standardizing or systematizing these pricing practices is essential.



Expected pricing usage in the next 5 years:

	 Increase	 Stay the same	 Decrease
Advisory fees (e.g., per hour spent, per structure designed)	92%	0%	8%
All in one model (one fee combining all of the above)	82%	0%	18%
Performance fees (e.g., on annual portfolio performance)	75%	17%	8%
Management fees (e.g., on assets under discretionary mandate)	60%	35%	5%
Custody fees (e.g., on assets held in custody)	35%	29%	35%
Transaction fees (e.g., by order executed)	17%	33%	50%



# Tax Reclaim, an innovative differentiator for your institution!

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Over the last few years, the Luxembourg private banking industry has been facing a series of challenges requiring a structural reshaping of its business model.

Luxembourg private bankers will have to differentiate and be innovative to maintain their attractiveness vis-à-vis clients that are—now more than ever—looking for advice to optimize their investments. In this context, efficient tax management of their clients' investments is a true value-added service that private bankers need to consider. Let's step back for a minute to understand the recent changes that have impacted the Luxembourg environment before investigating one of these new value proposition services: Tax Relief & Reclaim assistance.



### Moving toward a fiscally transparent environment

Since 2009, several initiatives both at the European as well as on the international level have impacted—and will continue to do so—the scope of banking secrecy, so that Luxembourg is now acting in a transparent fiscal environment full of challenges and opportunities.

This transition has been achieved with the switch to automatic exchange of information in the framework of the EU Savings Directive as from 1 January 2015, the signature of the Intergovernmental agreement Model 1 for FATCA purposes, and the implementation of the EU Directive on administrative cooperation in the field of taxation with regard to the exchange of information upon request and the spontaneous exchange of information.

The shift was further emphasized with the Common Reporting Standard (CRS). More than 80 jurisdictions will participate in this OECD initiative, more than 50 of which have already announced their intended starting date for CRS reporting. Based on the EU Directive, Luxembourg, as all other EU member states, will apply CRS reporting as from 2017.

In this new environment, the Luxembourg private banking center will not only be in direct competition with other international financial hubs like Switzerland, but also with homeland private banking players which are developing rapidly, providing services to resident clients and retaining the share of the richest individuals. In that context, there's a need for private bankers to offer innovative value proposition services: Tax Relief and Reclaim assistance is one such solution.

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## The level of automation is important to make it feasible to process high volumes, which is a necessary step to make Tax Reclaim a viable service offer within the bank's value proposition

### Tax Relief & Reclaim assistance: What is it in practice?

#### Introduction to double taxation issues

Each time an investment is realized on a cross-border basis, there is a risk that the income derived from such investment is taxed twice. One of the most common double taxation issues is the '*juridical double taxation*' where the same income is being taxed twice in the hands of the same taxpayer. For example, it is rather common that a dividend payment is taxed in the country of source<sup>1</sup> by way of withholding tax in first instance and then subject to income taxation in the investor's country of residence<sup>2</sup> by way of a tax assessment. As double taxation may discourage cross-border investments and affect their financial return, countries started to enter into bilateral tax agreements whose main purpose is to eliminate or reduce double taxation.

Most of the countries hence agree to levy lower withholding tax rates on dividend and interest outbound payments than the default rate applicable based on their local domestic tax legislations. Investors are then entitled to a tax credit for the remaining withholding tax leakage. In other words, the final withholding tax charge suffered in the country of source of the income can be deducted from the income tax due in their country of residence.

The benefit of the tax treaty rate can be granted either upfront at the time of the payment (**Tax Relief or Relief at Source**) or afterwards by way of a reclaim filed with the local tax authorities (**Tax Reclaim**). While the investor immediately receives an amount of dividend or interest after deduction of the correct reduced withholding tax rate under a Tax Relief method, under the Tax Reclaim method he/she suffers the full domestic withholding tax rate in first instance and receives the tax refund after filing the reclaim.

The refund methods vary from one country to another: for example, relief at source is available for French source dividends while Germany only offers the possibility to reclaim dividend withholding tax (no relief at source).

#### Tax Reclaim

A dividend paid by a German corporation to a Luxembourg resident investor would in principle be subject to an upfront withholding tax rate of 26.375%.

The Luxembourg investor can claim the benefit of the reduced dividend withholding tax rate (15%) based on the Germany – Luxembourg tax treaty, leading to a tax refund of 11.375% of the gross dividend amount.

The remaining 15% can be credited against the investor's Luxembourg income tax.

<sup>1</sup> Country of Source can be defined as the country of the security's issuer. For example, Germany will be the Country of Source for dividend paid by a German resident corporation and for interest paid on German government bonds

<sup>2</sup> Country of Residence can be defined as the country in which a person lives i.e. the country in which he or she has a place to live where he or she normally spends the daily period of rest. The tax treaty provides for some specific criteria to determine the residence of an individual person



### A key strategic differentiator

#### For Private clients

Tax Reclaim improves the performance of clients' portfolios. There are a lot of factors putting pressure on the wealth management and private banking industry, where it is getting more and more difficult to achieve significant returns. A successful implementation of Tax Reclaim processes could enhance clients' portfolio performance by 0.10% to 0.15% (see Figure 1) and consequently increases client portfolio AuM.

Private banks that succeed in launching these services will have a big advantage in relation to their competition. Tax Reclaim services can be a major differentiator when it comes to service offerings for U/ HNW (Ultra/High Net Worth) individuals which will not only increase client satisfaction and retention, but also attract new clients.

Figure 1: Example of potential quantitative impact of Tax Reclaim for private clients

### Enhanced client portfolio performance

Client portfolio performance is accrued by  
**0,10% to 0,15%**

- Increasing client retention rate
- Increasing client portfolio AuM
- Consolidating your reputation as a leading private wealth manager





### **For your institution**

#### *Customer management*

Today, we observe that Tax Reclaim is an emerging service provided by some innovative players. Nevertheless, Tax Reclaims are mainly performed on a case-by-case basis and upon request. Since Tax Reclaim is a time-consuming exercise and a long-term process, it is typically restricted to a few (Ultra) High Net Worth clients (UHNW or HNW clients). The challenge for banks is to transform the Tax Reclaim and embed this service in the banks' value proposition to be part of their overall service offering.

To do that, private banks will need to seek industrialized automated solutions. The level of automation is important to make it feasible to process high volumes, which is a necessary step to make Tax Reclaim a viable service offer within the bank's value proposition.

Tax Reclaims provide banks with strong leverage to improve client retention. In an environment where switching costs between banks are lower than ever, offering Tax Reclaims can prove to be a real asset for private banking players.

Tax Reclaim services offer the opportunity for relationship managers to get in touch with clients with good news which will not only create a 'wow effect' but also provide great opportunities for cross selling.

#### *Financial performance accelerator*

At the bank level, Tax Reclaims are a new source of revenue. The Tax Reclaims service may be easily invoiced to clients, as it brings value: "a win/win approach"—which will be perceived as offering both high-level technical expertise and innovative solutions. Currently, there are different pricing models in use on the market. The most common one combines a fixed fee for each individual claim on which a success fee (as a percentage of the recovered amount) is added.

#### *Focusing on value-added services*

More broadly, the Tax Reclaim can be part of a more general strategy—focusing on more expertise and more added-value services that enable private bankers to differentiate their value proposition. This will be a key differentiator in attracting increasingly demanding clients looking for specialized and knowledgeable advice on tax and investment optimization.

#### *Centers of excellence: Internal Tax Reclaims within a group*

Tax Reclaim can also be an opportunity for subsidiaries and branches belonging to a larger group to position themselves as a center of excellence—providing Tax Reclaim services to the whole group. Such a positioning makes sense since Tax Reclaims require fiscal expertise and can strongly benefit from economies of scale. The increasing competition between private banks calls for combination and scalability, creating strong incentives to pool services like Tax Reclaims.

For a banking group, it clearly makes sense to organize itself as a group capitalizing on centers of excellence, especially for Tax Reclaim services. Financial centers accustomed to dealing with cross-border investments—like Luxembourg and Switzerland—are advantageously positioned to provide these services which combine fiscal complexity and technical challenges.

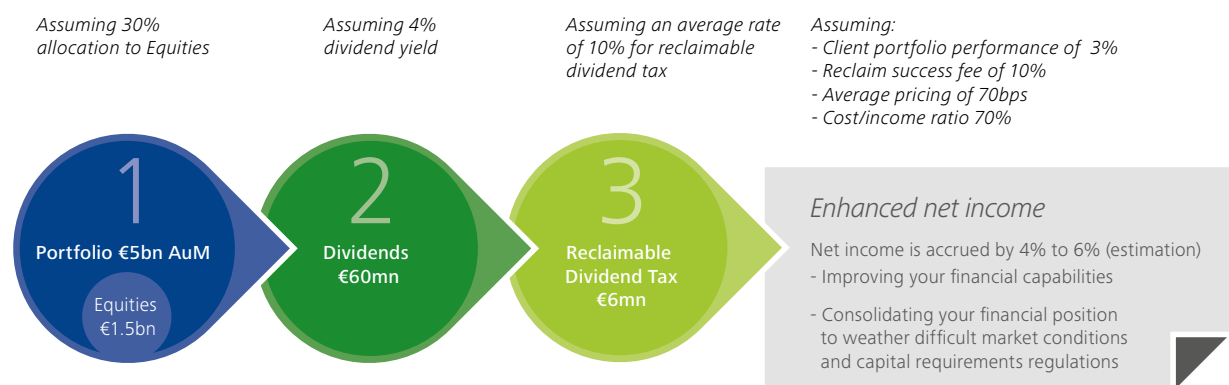
The definition of a Tax Reclaim center of excellence will offer different advantages:

- **Costs:** Combination and pooling enables lowering the overall costs related to such service at group level
- **Synergies:** The implementation of centers of excellence within a group enhances synergies within the group and will break silos
- **Increased net income:** Finally, the impact of such service on the bottom line can be significant. It can enhance net income by 4% to 6%. The goal is twofold:
  - Improve the financial capabilities
  - Consolidate the financial position to handle difficult market conditions and capital requirement regulations
- **Profit center:** Consequently, Tax Reclaim is far more than a new service. It offers the opportunity to shift a full area of services from being a cost center to becoming a new profit center

A lot of products and services offered by banks are currently facing an increase in costs, regulatory pressure, low profit margins, and fierce competition, which is causing their added value to decrease. To close this gap, banks need to lower the costs while increasing the perceived value of some products, and introduce innovative offerings to attract and retain clients as well as to create new revenue sources.

From this perspective, the Tax Reclaim service is a great opportunity for private banks. Although it may be difficult to invoice tax reports to clients, it is possible to bundle tax reports and Tax Reclaims, for example, and to sell a combined offer. As Tax Reclaims generate value for private clients, it is easier to justify the pricing.

Figure 2: Possible impact of tax reclaim on the net income



### An organizational and operational challenge

The implementation of a Tax Relief & Reclaim assistance service must be carefully prepared as it entails many operational and organizational challenges. We have highlighted some of these challenges below.

#### Catch and keep the tax knowledge:

##### “The withholding tax matrix”

Before offering a Tax Relief & Reclaim service to their clients, private banking players will have to prepare a withholding tax matrix (hereafter the “matrix”) which has to contain all required information to identify Tax Reclaim opportunities for their clients and then file the request with the competent authorities.

The main challenge will be to ensure that this matrix is up-to-date and captures any changes in both domestic legislation and tax treaty networks that may affect the investors’ right of refund. Access to a large network of local tax experts is crucial, to remain abreast of any relevant developments.

#### Client segmentation

Another key element is determining what commercial approach to pursue: offering this assistance to top-tier clients or expanding the service to a wider client base. This decision will naturally influence the volumes to be processed and impact the (internal and/or external) resources to be dedicated to the project.

Based on client data extracted from the bank’s systems, a cost/benefit analysis should be performed in order to determine the viable claims per client i.e. the claims where the cost of pursuit is lower than the estimated tax refund. It is crucial that this cost/benefit analysis is automated allowing the bank to rapidly identify relief/reclaim opportunities, start gathering all required information and documentation to make available to the local paying agents for the Tax Relief Service, and to prepare the Tax Reclaim to be filed with the local tax authorities. Such automation is even more important when the service is offered to a large number of clients.

### Highly secure transfer of client data and information

A tax Relief/Reclaim service requires dealing with client data and information and sharing them with external stakeholders such as local paying agents and external tax service provider. It is therefore critical to set up a highly secure technology-backed solution that allows the bank to remain in full control of its client data at all times.

The connection between the bank and the external stakeholders will also need to be secured to offer a high level of security. Depending on the volumes to be processed, a secured data sharing platform would be essential to provide easy and centralized access to client data and information in a secure environment.

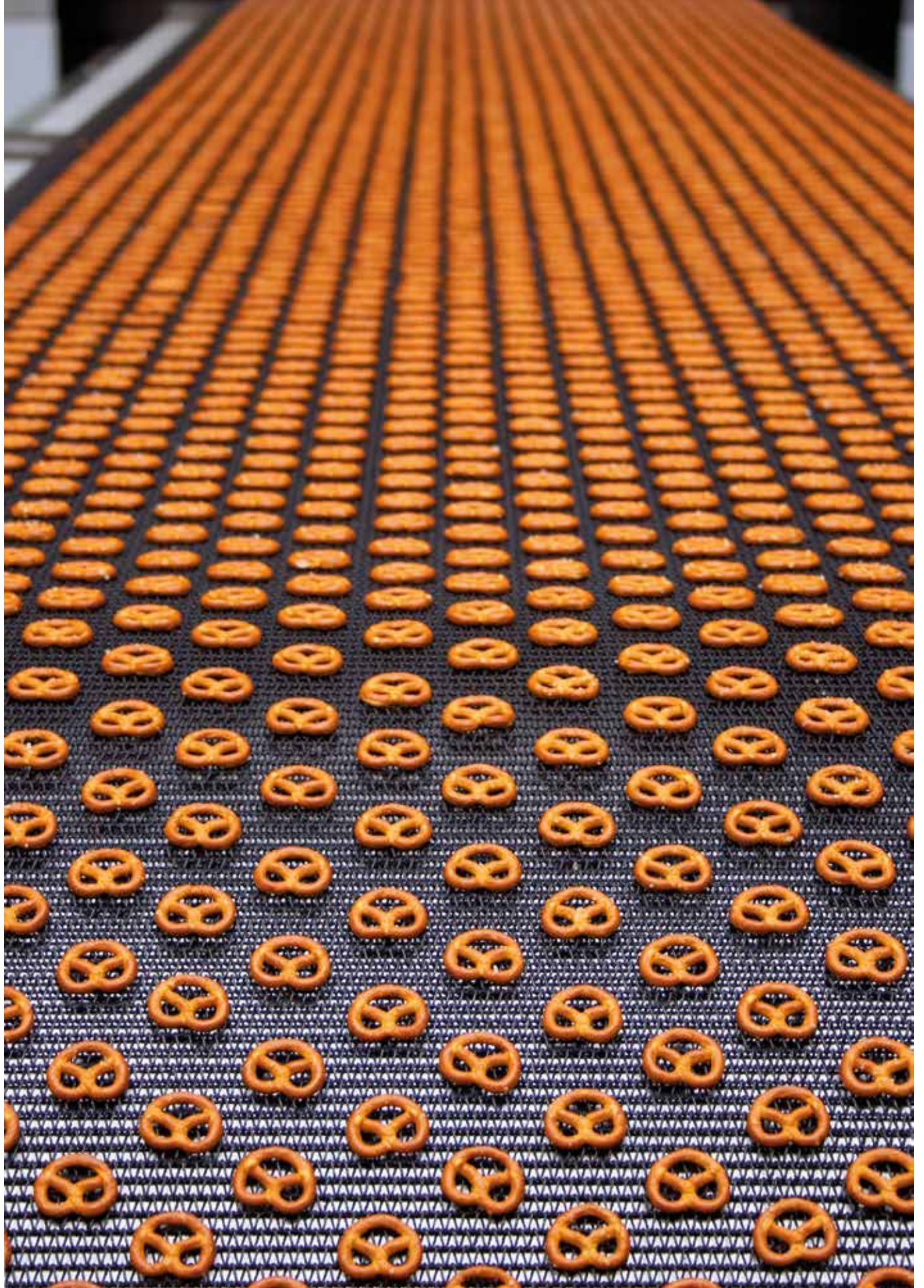
Although the private banking industry is facing challenging times, there are plenty of opportunities to successfully navigate troubled waters. A Tax Relief/reclaim assistance service requires a good understanding of the operational and organizational impacts, combined with an excellent management of tax information. But it provides clients with a distinctive value-added service where they can benefit from tax refunds, improving the return of their investment portfolio. Who said the power to tax is the power to destroy<sup>3</sup>?

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Tax Reclaim services offer the opportunity for relationship managers to get in touch with clients with good news which will not only create a ‘wow effect’ but also provide great opportunities for cross selling

3 Chief Justice John Marshall in 1819 US Supreme Court Ruling., *McCulloch v. Maryland*.









# Private banking transformation

## Reinvented proposition for higher customer value, B2C and B2B

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### What trends are shaping the business

The recent financial crisis has led to a movement toward new and enhanced regulations as well as a push toward increased tax transparency aimed at protecting both the banking system and its clients. In addition, a combination of poor market performance and shifting client preferences is keeping the industry's revenue base under pressure, forcing private banks to rethink their vision as well as their business and operating models while coping with constant profitability concerns.

In terms of revenues, Europe is still a rather lucrative market with private banks reaching pre-tax profit margins of 25 to 27 bps on average, compared with 18 to 21 bps of Asia-Pacific institutions. The emergence of new actors such as independent financial advisers, however, forces private banks to find new ways of making profits while keeping prices low. **Luxembourg private banks, and private banks in developed countries more generally, have to optimize their value propositions in order to gain market share while focusing on cost efficiency.**

Private banking business models in Luxembourg were established based on historical relationships, with value propositions capitalizing in particular on offshore

status. Private banks focused on attracting assets, while keeping comfortable pricing models and achieving maximum excellence or efficiency was not seen as the utmost priority. However, the landscape has changed considerably in the past decade.

Firstly, client needs are evolving, leading to clients having higher expectations and requiring new value-added services such as asset structuring, tax reclaim or opportunity to invest in collectible assets, etc. At the same time, several parallel evolutions are forcing banks to cut their prices. Clients' cost-sensitivity is increasing and new regulations are obliging banks to provide greater transparency and only price products and services that provide real added value to their clients. The challenge of the retrocession following MiFID II is perhaps the most pertinent example of this trend.

Moreover, following the financial crisis, there has been a considerable growth of External Asset Managers (EAMs) and Independent Financial Advisers (IFAs) who promise better, cheaper and unbiased services to their clients. Many clients choose to change from their private banks to these new actors as a result, and banks are forced to accept that a rising share of their business is introduced through business intermediaries.

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## The rise of these new actors and their increased importance in the wealth management landscape does not leave a lot of leeway for banks

All these changes in the financial marketplace necessitate the banks to reassess their value propositions, operating models and organizational structures. In particular private banks need to:

- **Recognize the importance of new actors**, such as IFAs and EAMs, as drivers of business and adapt their business models accordingly
- **Develop a clear value proposition** with the right level of service and expertise for clients (both direct and intermediary), and with the right pricing model
- **Maximize cross-selling** between different departments of the bank in order to deliver the best value to clients and optimize profitability

### Emergence of business intermediaries

By having access to multiple sources of information (internet, relationship managers, mobile banking, etc.), clients not only benchmark the offering between players in terms of breadth, depth and quality of services but inevitably also in terms of pricing. Private banking clients are becoming more and more price-sensitive and can exert pressure on banks' pricing structures. In addition, the new generation of clients is also less loyal to their respective services providers and therefore more likely to swiftly move from one asset manager to another in the search for better service.

A couple of years ago, new actors such as IFAs started to emerge from a low base and now own a non-negligible share of the wealth management market. As a textbook example of open architecture, IFAs—as their name suggest—should be independent and therefore forced to search for the best products for their clients' asset allocation. This is highly appreciated by clients and creates a considerable degree of competition for private bankers. As a result, numerous private banking clients decided to re-evaluate the service offering of their banks and the value they are getting for their money, and a considerable share decided to switch to these new players in the market.

However, although these actors compete with private banks for clients, they also rely on them for support services, such as custody, transaction services and reporting, etc. This creates an enigma for private banks. To which extent shall they embrace the external parties as new clients and develop a real B2B value proposition, and to which extent shall they focus on direct private banking clients in the traditional sense? Banks often accept a certain level of business introduced to them through IFAs, as the client accounts continue to remain in custody with the bank. This arrangement is nevertheless not without conflict as the two players can have overlapping roles. Moreover, business intermediaries pose a financial challenge for banks considering that the revenues gained through assets in custody are considerably lower than those obtained through direct private banking services.

However, **the rise of these new actors and their increased importance in the wealth management landscape do not leave a lot of leeway for banks, and force them to consistently include IFAs, EAMs and other business introducers in their private banking strategies.** On the positive side, these intermediaries provide the banks with a new distribution channel for their own products and services, and in case of a compelling value proposition developed for these actors, the volume of business introduced through them will, to a certain extent, make up for the lower profitability.

From an organizational perspective, the question concerning the potential need for a “Chinese wall” between the pure private banking business and the IFA/EAM business at private banks arises, as these actors naturally feel at risk of being bypassed by the private bankers who might decide to target the final clients directly. Our market analysis clearly identified the need for such a Chinese wall from an IFA’s/EAM’s perspective. However, a real split is rather an exception than a rule in the marketplace today. The establishment of a Chinese wall would mean the creation of a separate department or desk as part of the bank’s B2B activity and potentially lead to a duplication of certain processes and/or competencies (e.g., regarding commercial force etc.).





### Increased importance of cross-selling

Moreover, not only are (U)HNWIs targeted by both private banks and the new actors in the market, large universal banks covering retail, private and corporate banking also target the same clients within their various departments, creating large clients overlaps. This often leads to clients having multiple points of contact at the same bank, and in some cases being exposed to different commercial offerings. The commercial risk of a client, be it a business intermediary or a private individual, receiving two different offers from the corporate and the private banking departments of a universal bank, or even from two different regional desks of one single private bank, is considerable.

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## Organizational and remuneration models need to be adapted to ensure that all experts and departments are incentivized to work together to provide clients with a single view and response

Therefore, avoiding silo effect through strong corporate governance is key. **Organizational and remuneration models need to be adapted to ensure that all experts and departments are incentivized to work together to provide clients with a single view and response.** Only serving the client with the best resources available at the most competent department of the bank for the specific service the client is looking for, will enable the bank to provide the highest value and ensure client satisfaction. The principle of remunerating teams and employees on the basis of the assets booked

at their specific department only, is outdated. The challenge of today is to develop effective incentive schemes promoting cross-selling between the various departments of the same bank. Similarly, clear contacts, vis-a-vis clients, need to be established in order to eliminate the risk of double-treatment.

### Changing role of the relationship manager

Coordination of activities may be ensured through the establishment of a Single Point Of Contact (SPOC) for each client. A SPOC can be seen as a modern relationship manager—a senior employee with extensive expertise and profound knowledge of the bank's service offering, who is able to direct the client to the various centers of expertise within the bank for the service in question, such as patrimonial services, credit structuring or the IT platform support team for IFA clients, etc.

The goal is to develop a strong integrated banking offering which combines traditional wealth management with loans, banking and other services enabled by the bank's infrastructure. Advisory models need to evolve to reflect the increasingly sophisticated client needs and bring more added value to clients. The relationship manager shall act as an assembler of know-how and remain the client's trusted adviser for any issue. **The client's specific needs, however, shall be met at the various competence centers within the bank.**

### Summary: outstanding challenges

The central private banking challenge is how to maximize the value of existing wealth while also focusing on new wealth creation. However, as the strategies that might have worked in the past are no longer effective in this ever-changing market landscape, the traditional private banking players are forced to re-evaluate and adapt their business and governance models.

One of the main forces challenging the status quo are new actors, such as IFAs, entering the market. These do not only provide competition but also create a new client segment for private banks, leading to a transformation of private banking from a pure B2C to a mixed B2C/B2B business. The challenge is to carry out effective client segmentation and develop a clear value proposition for all target clients of the bank. **These elements are crucial in order to move from an inconsistent opportunistic approach to a consistent and structured strategic approach across all departments of the bank.**

At the same time, banks need to establish coordination mechanisms between departments and put effective cross-selling practices in place in order to ensure that existing and new clients are covered with the right offering and capabilities. Business models of private banks need to be built on core values and a clear definition of target clients and their needs. Moreover, the role of the relationship manager as a SPOC should ensure that the client is referred to the most knowledgeable department of the bank for the specific service in question. Only this approach will ensure client satisfaction and sustainable revenue generation.

New actors and developments in the marketplace create new challenges but at the same time new opportunities, and are forcing private banks to rethink their business models as a whole. **Only those institutions that manage to increase the real and perceived value of their products and services - while keeping its costs down - will be able to develop a sustainable business model and prosper in the future.**



# Millennials and wealth management Trends and challenges of the new clientele

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The financial crash and the volatility of the markets have led to a state of general distrust toward financial institutions, especially among the millennials. Furthermore, this clientele imposes other requirements on wealth managers than the previous generations. The fact that millennials will be the largest client group is therefore driving many wealth managers to assess their business model as well as the way in which they interact with clients to identify which adjustments are necessary to successfully serve millennials. Early adoption will enable them to protect market share and keep their leading position. This article highlights the trends and challenges of the new clientele for the private banking industry.









### **Millennials are going to be the largest adult segment by the end of the decade**

The population of millennials—also known as generation Y—has been constantly growing over the past years and this year it will be the largest generation ever. The term millennials is usually considered to apply to individuals who were born after 1980 and reach adulthood with the turn into the 21<sup>st</sup> century. In 2015, it is expected that 40 percent of the global adult population will be under 35 years old with strong growth rates predicted for the coming years. It comes as no surprise that Asia represents the largest proportion – nearly two-thirds of the millennials are Asian – however developed regions, such as Europe and the Americas, represent a significant proportion with more than 25 percent as well.

Whilst being the largest adult segment, millennials are also expected to grow their wealth significantly in the next years. Until 2020, the aggregated net worth of global millennials is predicted to more than double

compared to 2015, with estimates ranging from US\$19 to 24 trillion. Certainly most of the millennials are currently still in the phase of creating wealth, but there is going to be a massive shift in the future driven by three major trends. First of all, with an age ranging from 18 to 34 at present, millennials are about to enter their prime earning years, resulting in a meaningful increase of liquid assets. Second, being self-employed as an entrepreneur is a key role model for the millennials and this will accelerate the increase of assets. In developed countries, 54 percent of the millennials started or plan to start their own business, while 27 percent are already self-employed. Furthermore, millennials will benefit from the wealth of their baby boomer parents. Nowadays more than two-thirds of the wealth managers' clients are over the age of 60, driving the future wave of inheritance. These are a few reasons why wealth managers should start focusing on the millennials.



### Millennials' behavior differs significantly compared to the previous generation

When dealing with millennials, banks are more and more challenged by the fact that this segment is demonstrating different behaviors compared to older generations. In terms of personal values, 75 percent of millennials want to stay authentic and refuse to compromise family or personal values. In addition, almost two-thirds are not only concerned with the state of the world, but also feel obliged to change something. This is reflected by the fact that millennials refuse to consider money as sole success factors and give more value to brands and employers who act socially responsible. With regard to economic conditions, millennials were highly influenced by past crises. The financial crisis, as well as the volatility of financial markets, made millennials relatively cautious and conservative in regard to financial matters. At the same time, millennials highly demand and make use of technological advances. Consequently, they consider technology and online platforms an important aspect of financial advice. 57 percent would even change their bank relationship for a better technology platform solution. All of those trends are determining the way wealth managers should interact with millennials.

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In developed countries, 54 percent of the millennials started or plan to start their own business, while 27 percent are already self-employed

First of all, banks need to overcome the lack of trust resulting from the financial crisis. Although 72 percent of the millennials describe themselves as self-directed with direct control over their wealth, they also tend to lack financial knowledge compared to older generations. 84 percent of millennials seek financial advice clearly highlighting the fact that, despite the skepticism about advisers, the necessity for world class investment advice is still in demand. Furthermore, banks need to compensate the risk-aversion of millennials resulting in lower revenue margins. Less than 30 percent of millennials' wealth is invested in stocks and, contrary to the previous generation, they prefer physical assets as well as cash and demand simple, clear and straightforward products. The current low





interest rate period is certainly influencing this behavior; yet it is still expected to differ significantly from the previous generation. On the other hand, millennials are increasingly demanding socially responsible or even impact investments and tend to mistrust social security systems for their own retirement needs, which gives rise to a new line of product offerings.

Another trend requiring wealth managers to react is the way millennials are seeking classical investment advice. Millennials increasingly consult peers and media before acting on adviser recommendations; less than 10 percent of investment decisions are made alone. At the same time, word-of-mouth and personal recommendations significantly influence the buying decisions of about 50 percent of millennials. However, millennials still value traditional media and face-to-face meetings for advice, 82 percent would even appreciate more personal meetings with their investment adviser. This clearly highlights that the majority of millennials regard technology as an additional way to communicate and invest, but not as a substitute for personal interactions provided by a wealth manager.

#### Implications for wealth management firms

The different behaviors derived from the personal values of millennials implicate new challenges to wealth management firms. The need and individual characteristic of the millennials are not as yet adequately met. It is possible to differentiate three types and characteristics of millennials.

Many millennials possess a low-to-medium level of financial knowledge. For these clients, wealth management firms need to find out how strong the interest for a deep financial understanding is. If the need to get a deeper insight exists, wealth management firms are obligated to find a way to educate the client on financial terminologies and products based on the prevalent knowledge. The language, which the wealth managers use, has to be clear, simple, and understandable for the inexperienced millennials.

As a wealth manager, it is required to understand that the advice will be cross-checked with external sources, as millennials tend to not fully trust their adviser. This raises the next characteristic wealth management firms need to address: a lot of millennials have a negative perception of financial advisers.

To overcome this negative attitude, wealth management firms initially need to focus on the pricing transparency. All fees should be clear, reasonable and fair to the client. In this context, flat fees are problematic and less accepted than a performance fee. Furthermore, it is unconditionally compulsory to offer customized advice, keeping in mind unique needs. A wealth management firm must therefore also possess a certain skillset in more specific areas such as alternative investments, markets and products. As digital natives, millennials have much higher expectations to communication and transparency. This also includes social and environmental aspects.

Another characteristic of the millennials is their preference to be self-directed in their investments, assuming they do understand the financial markets and know the diverse range of products. Wealth management firms are required to offer the necessary channels for this client segment. They should get the support of the wealth manager if needed, supporting them to make their investment decisions by themselves. Products should therefore be designed in a way that resonates well with the customers' expectations, with a special focus on state-of-the-art technological platforms. Technological communication platforms need to be able to transfer information about their wealth quickly and at every point in time during the investment cycle.

It is absolutely essential, therefore, that services have a value-added function in a quality visible for the millennials. To generate this value, wealth management firms should reflect the voice of the customers in target aspects of marketing, products and operations. Failure to adapt will result in a continued mistrusting.

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## Almost 90 percent of millennials check their smartphone within the first 15 minutes of waking

### New firms are leveraging digital technology to disrupt financial services

The change in client needs and the new digital technology have given new opportunities to financial institutions with innovative revenue models. There are wealth management providers that offer all their services online. The online advice and offering in algorithmic trading solutions enable cheaper alternatives to managed accounts from multichannel wealth managers. Another new business model is known as social investing. E-communities connect investors from different backgrounds around the world to online platforms where they share investment ideas, see others' portfolios and are able to copy other investors' investment strategies.

Successes of those business models can be attributed to the right understanding of client channel behavior. Whilst older generations –baby boomers and generation X– have a higher preference for more traditional channels such as personal interaction and mail, millennials have embraced newer technologies to interact with their financial institution. Digital firms manage to leverage new technologies to deliver products and services to customers by offering a seamless, liquid user-experience across multiple channels.






In 2015, over 80 percent of millennials own a smartphone with numbers steadily growing. 89 percent of those millennials check their mobile devices within the first 15 minutes of waking. Checking on social networks represents the first action in 37 percent of those cases. Leveraging this kind of interaction is at the core proposition of each new technology firm. One example is E-Toro, an e-community for forex enthusiasts which pushes new investment ideas and headlines to the mobile users in real time. A direct connection to the in-house brokerage service ensures that users are always ready to make swift investment decisions at the tip of their fingers thanks to the 24/7 connectivity of the service.

As shown in the case of e-Toro, digital firms can help to address the gaps between expectation of the next generation HNWIs and the offerings of wealth management providers. Offerings from digital firms responding to the demand of millennials vary widely and can be clustered into three main client segments (see figure 1):

1. Clients who possess low-to-medium level of financial knowledge
2. Clients who prefer to be self-directed in their investments
3. Clients who hold a negative perception of their advisers

Figure 1: Clustering of digital firms' offering in three main segments

	The novice	The loner	The cautious
	Low financial knowledge Your future investor	Self-directed Your future enthusiast	Negative perception Your future referrer
 <b>Information</b>	<ul style="list-style-type: none"> <li>• Concise information</li> <li>• Simplistic investment data</li> <li>• Social media interaction</li> </ul>	<ul style="list-style-type: none"> <li>• Detailed information</li> <li>• Technical investment data</li> <li>• Real-time access to data</li> </ul>	<ul style="list-style-type: none"> <li>• Clear information</li> <li>• Transparent investment data</li> <li>• No hidden fees or kick-backs</li> </ul>
 <b>Services</b>	<ul style="list-style-type: none"> <li>• Virtual investment portfolio</li> <li>• Investment learning tutorials</li> <li>• Passive investment mandate</li> </ul>	<ul style="list-style-type: none"> <li>• Social investment clubs</li> <li>• DIY structured products</li> <li>• Algorithmic trading solutions</li> </ul>	<ul style="list-style-type: none"> <li>• Face-to-face consultation</li> <li>• Performance-based fees</li> <li>• "Case-by-case" pricing</li> </ul>
 <b>Technology</b>	<ul style="list-style-type: none"> <li>• Demo trading account</li> <li>• Simple portfolio builder</li> <li>• Online investor school</li> </ul>	<ul style="list-style-type: none"> <li>• Algorithmic investment tools</li> <li>• Custom invest. product builder</li> <li>• Mobile investment solutions</li> </ul>	<ul style="list-style-type: none"> <li>• Online meeting feedback</li> <li>• Adviser peer comparison</li> <li>• Benchmark my performance</li> </ul>



To avoid disruption, traditional wealth management firms will need to transit into the digital age. Once the decision to proceed is made, there are two possible options to consider.

First, there is the possibility to invest in the digital experience. Providing digital offerings requires building a strong fundament of capabilities such as requirements engineering, user-experience design, technical architecture, development services and digital channel marketing. Furthermore, it necessitates investing in the right infrastructure (digital platform, products, services, channels) and employing key resources to drive the implementation (software developers capable of developing and delivering modern financial technology, advisers trained in using digital, UX specialist, data engineers, financial modelling experts) to deliver a state-of-the-art digital experience to the customer.

For wealth managers who prefer to stick to their core business of offering investment services, the second option to form strategic partnerships might be a better fit. Long-established wealth managers can form partnerships with firms that can fill the gaps of knowledge, technology, and skills required in the digital environment.

Irrespective of the applied option, private banks will need to become a part of the digital wealth ecosystem.

All wealth managers are facing new marketing and product development challenges from the millennials generation and need to respond accordingly. The longer wealth managers delay in doing this, the more costly the change is likely to be when it finally becomes inevitable. Furthermore, they risk losing market share to early adopters. Another value of millennial consumers is not just in the scale of the opportunity they represent, but in their capacity to drive changes across the entire bank. These changes can deliver benefits to all generations and create more valuable franchises and channels for those banks that rise eagerly to meet the millennial challenge.

Recent announcements of global wealth management providers about investments in their future, such as the launch of digital programs, indicate that the industry is starting to respond to the rising demands of the millennials clientele. However, not all banks have accepted this challenge yet.



# The Middle East



# Challenges and opportunities for global and local asset managers

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## **The Middle East economies have grown strongly in the past few years**

**The region has bounced back strongly from the crisis in 2008, and nations have increased their efforts to diversify their economies.**

Middle East growth has picked up strongly following the financial crisis of 2008-2009, driven to a large extent by growth in the Gulf Cooperation Council countries (GCC)—composed of Saudi Arabia, the United Arab Emirates (UAE), Qatar, Kuwait, Oman, and Bahrain. The GCC region's real GDP growth rate averaged 5.2% from 2010 to 2014, thus outperforming most developed countries throughout the period<sup>1</sup>.

Most GCC countries have benefited from high oil prices over the past decade, which contributed to significant wealth creation, for both institutional and private investors. Oil revenue still represents the majority of the region's GDP, but the countries are making efforts to diversify their economies. The UAE and other countries in the region have launched development plans (e.g., Abu Dhabi Vision 2030, Qatar National Vision 2030, UAE Vision 2021) to develop other sectors such as aviation, tourism, transportation, and financial services.

Oil revenues have allowed the countries in the region to invest heavily in infrastructure projects that today form a solid base for the development of a more diversified economy. However, the recent fall in oil prices could challenge near-term growth and investments, but long-term perspectives remain favorable in terms of oil and non-oil development.

## **The Middle East asset management industry is gaining in maturity and is no longer a purely institutional business**

The total wealth pool in the region today amounts to approximately US\$5.2 trillion and local Sovereign Wealth Funds (SWFs) represent almost 50 percent of this wealth. The remaining wealth is split between other institutional investors such as local pension funds, as well as mass affluent investors and (U)HNWI investors in the non-professional segment. The growth in local wealth results from global capital markets growth as well as the strong growth of GDPs in the region. Local wealth growth outpaces the growth observed in most other regions.

<sup>1</sup> Source: Institute of International Finance



International as well as local asset managers have recognized the importance of the region in terms of potential asset collection, and have started to increase their local activities over the past decade. Historically, asset management activities in the Middle East have focused on SWFs and other institutional investors. Recently, however, we have seen asset managers increase their range of investment funds in the region that are addressed to private investors. In particular in anticipation of the opening of the Saudi Arabian stock market to foreign investors, there has been an increase of almost 10 percent in the number of investment funds operated in Saudi Arabia in 2014. There is also increased interest in the distribution of UCITS structures into the Middle East region, reflected in the increasing number of UCITS approved for distribution in the various countries.

**The mass affluent segment shows one of the strongest relative growth rates in private wealth**

The mass affluent segment shows the strongest growth in wealth from 2009 to 2013, with a CAGR exceeding 15 percent. This segment is composed of Western, Asian, and other expatriates who tend to keep their home banking services providers and asset managers when moving into the region and tend not to invest large portions of their wealth in the region. While historically this segment may have suffered from a home market bias in terms of asset management choices, the length of expatriates' stay in the region is increasing, and is expected to encourage local investment choices<sup>2</sup>. The mass affluent segment also recorded an increase in the number of households over the past five years, indicating the creation of a financially stable middle class in the region, which supports the long-term economic development of the region in general.

**The (U)HNWI investor segment is undergoing a generational shift impacting investment behaviors and needs**

HNWI and UHNWI investors represent the largest segment of non-professional investors in the region in

terms of wealth, and have shown continued growth over the past few years. The majority of investors in this segment are GCC nationals. The generational shift in this segment raises questions of how to align the traditional values of the current generation with the new, more modern perspectives of the younger generation, and the impact on their investment behavior.

The current generation's investments are characterized by highly liquid, low risk assets with emphasis on capital protection. On the other hand, the younger generation has a more aggressive investment approach with higher expected returns, shorter time horizons, and seeks wealth generation rather than wealth preservation. This new generation of investors also shows an increased interest in professionalizing their private portfolios in terms of asset allocation and diversification. This creates opportunities for asset managers to provide professional solutions to those investors. Furthermore, GCC investors tend to appreciate tangible assets such as real estate - "*Property gets sick but it never dies*" is a commonly used proverb to explain the lure of such assets for local investors.<sup>3</sup>

Most assets in the (U)HNWI segment are held offshore, in part due to the lack of actively managed investment opportunities with a good track record in the region. We observe a low penetration of private wealth by professional asset management products. In 2012, roughly US\$56 billion of the total US\$2.2 trillion wealth pool in the region was captured by professional asset management products locally (i.e. investment funds and/or discretionary mandates). This is also due to the fact that many wealthy families have their own wealth advisor to ensure discretion and are not linked to professional advisors. However, both professional and non-professional investors have shown increased interest in Sharia-compliant structures as well as regional investment products, but the demand significantly outpaces the supply of such products, indicating the strong growth potential for asset managers.

<sup>2</sup> Invesco Middle East Asset Management Study 2013

<sup>3</sup> Ibid.



**Regional financial centers continue to emerge with the ambition to enter the top tier of global financial centers**

The financial industry in the Middle East has seen strong growth over the past decade. Today, four Middle Eastern financial centers appear in the top 35 following the Global Financial Centers Index 2015, namely Qatar (26<sup>th</sup>), Dubai (29<sup>th</sup>), Riyadh (31<sup>st</sup>), and Abu Dhabi (32<sup>nd</sup>). In consequence, global banks and asset managers have constantly increased their presence in the region and local banks have been expanding into non-interest income activities such as asset management to reduce their exposure to the highly competitive core banking activities.

Despite this increased activity, we still observe certain areas for improvement in the financial centers, which limit the ability of industry players to commit to on-the-ground investments and increased activity. These areas for improvement include capital markets liquidity and the development of robust regulatory and legal frameworks.

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The revenues from oil sales have allowed the countries in the region to invest heavily in infrastructure projects that today form a solid base for the development of a more diversified economy

**While still small, the local capital markets are showing progressively more sophistication and liquidity**

The market capitalization of GCC stock markets was about US\$1 trillion in December 2014, with Saudi Arabia accounting for almost 50 percent with US\$480 billion. While market capitalization has increased steadily over the past decade, regional markets are still limited in terms of asset classes and investor groups such as pension funds, insurance companies, and large investment companies. These are important elements of a sound financial system that eventually support the development and growth of the overall economy.

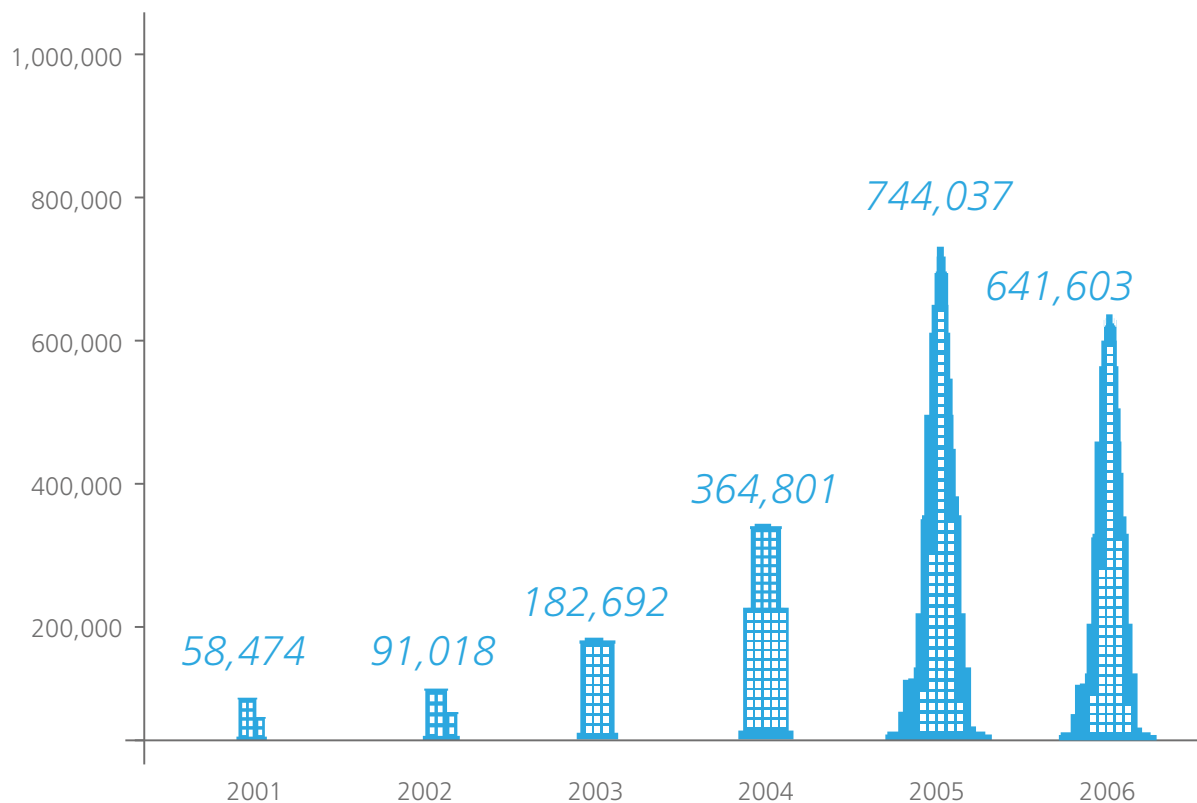
Some of the local capital markets have been closed to foreign direct investments and are now slowly being opened to foreign investors, which will ultimately increase liquidity. Especially, the opening of the Saudi

Arabian stock market to qualified foreign investors, planned for the first half of 2015, is widely considered a milestone in the development of the regional stock markets and likely to increase the liquidity in the Tadawul, the Saudi Arabian stock index. Also, the increased presence of GCC indices in global emerging market indices (e.g. Qatar's increased weight in the MSCI Emerging Markets index) is expected to have a positive impact on the capital markets' liquidity in the region<sup>4</sup>.

**Legal and regulatory regimes are gradually evolving toward global standards**

The stability of the regulatory and legal environments is a requirement for the development of the asset management industry. Regulatory frameworks are evolving in the different regions (e.g. DIFC, ADGM, QFC) to ensure clearly recognized and enforced

**GCC market capitalisation evolution (in current US\$ million)**



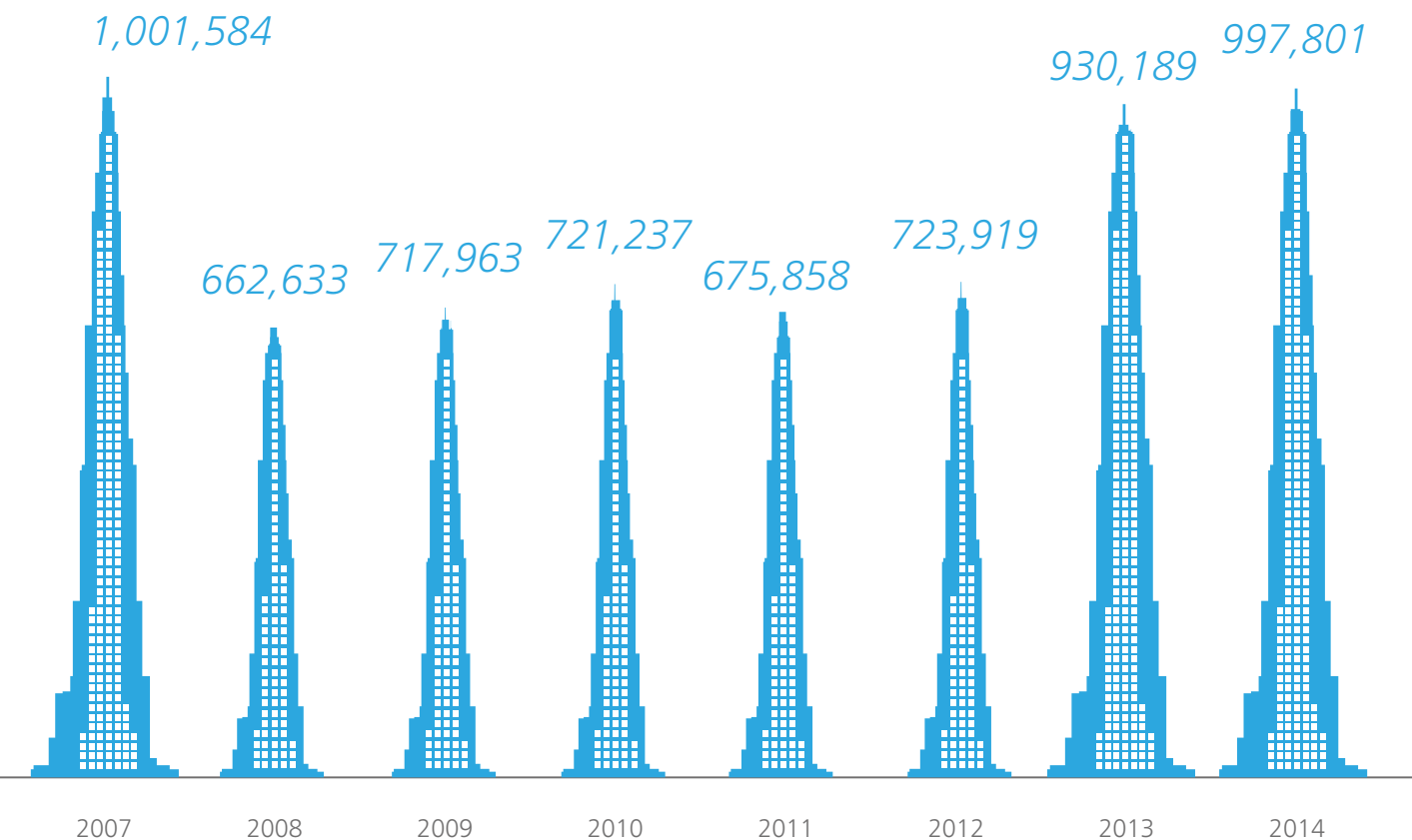
<sup>4</sup> [http://www.khaleejtimes.com/biz/inside.asp?xfile=/data/uaebusiness/2014/September/uaebusiness\\_September177.xml&section=uaebusiness](http://www.khaleejtimes.com/biz/inside.asp?xfile=/data/uaebusiness/2014/September/uaebusiness_September177.xml&section=uaebusiness)

operating standards, upon which financial services providers can build their strategy and operations. Even though the GCC countries are considered relatively safe havens compared to other jurisdictions in the Middle East and North Africa, local regulators are still defining and setting up the regulatory regimes.

This evolution is creating both opportunities and challenges. As industry practices become more transparent, investor confidence and operator interest will continue to grow. At the same time, the complexity and cost of ensuring compliance with tightening regulatory standards will increase, in particular considering the multiple, country-specific frameworks present in the region.

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International as well as local asset managers have recognized the importance of the region in terms of potential asset collection, and have started to increase their local activity over the past decade







### Considerations for asset managers

#### **Asset managers need to continue developing propositions tailored to private client needs**

The mass affluent segment is particularly interesting for asset managers. Those investors are generally well educated and might already be served with existing products from global asset managers. However, given the increase in the number of households, there is likely growth potential in this segment, as they need increasing amounts of financial advice when moving along their career paths and growing their net wealth. Despite the high cost sensitivity of this segment, which asset managers must consider in their product offering, product needs are generally basic and straightforward, and no complex asset allocation strategies are required. Moreover, the client relationship can be relatively limited and could for example be centered on digital access, thus reducing costs for the asset manager. Such “execution only” service models with limited advice costs should be considered, but require higher degrees of systems automation for asset managers to operate profitably.

Opportunities to better serve the (U)HNWI segment also exist. The generational shift offers opportunities for asset managers to establish connections with the new generation and their specific need for professional advice.

This could also be used as a foot in the door to establish a link to the current generation, by understanding their investment needs and translating them into easy-to-understand investment propositions. (U)HNWI have historically been one of the most favored client segment for asset managers due to the high margins linked to this client base. However, competition in this segment is intense and it may be difficult to convince clients with a long-term relationship with existing Single or Multi Family Offices (SFO/MFO) to enter into new wealth management relationships.

Besides the macro segmentation of the non-professional investors, asset managers should consider the demographic composition of the different countries and markets. Even though GCC nationals dominate the (U)HNWI segment, expatriates are also represented and have different investment habits that should be considered by offering specially tailored products to this sub-segment. The same rule applies to the mass affluent and retail segments, where expatriates from the Asian countries can wield increasing investment power.

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# The increasing wealth and thus investment potential of mass affluent investors and the new generation of (U)HNWI investors require asset managers to rethink their distribution strategies and product offerings

## **The changing regulatory landscape needs to be closely monitored**

The increasing number of regulatory regimes in the region, that aim to define a framework for asset managers and financial services providers to operate in, creates opportunities for those players to position themselves in the market in the appropriate way. However, as those regimes are still under development and most likely subject to further amendments, asset managers need to implement regulatory watch processes to closely monitor the evolution of the regulatory regimes applicable to their entities and assess their impact on their existing business models. New or changing legal requirements may just represent additional workload (e.g. additional reporting requirements), but may also offer new business opportunities to asset managers (e.g. creation or permission of new product classes) into which they (quickly) need to tap if they want to benefit from the momentum created by such amendments or new laws.

## **On-the-ground sales teams are not sufficient to build long-standing relationships**

Global asset managers often limit their presence to local sales teams or representative offices in order to manage the assets in the global financial centers. However, establishing relationships with wealthy investors in the region is a long-term project and such relationships are built over several years with regular face-to-face contact. We think that this is one of the reasons why global asset managers have failed to capture more of the available wealth into their asset management products.

## **Asset managers have to rethink both their distribution and product strategies**

The increasing wealth and thus investment potential of mass affluent investors and the new generation of (U)HNWI investors require asset managers to rethink their distribution strategies and product offerings.

Digital channels have become a key selling point of a complete asset management value proposition and go beyond the provision of account statements in electronic format. The digital channel should offer a complete service with information and transaction execution features as well as advising features and a link to the relationship manager. It should also be possible to switch between interaction channels without any problems (e.g. from mobile applications to face-to-face advice in a branch).

This increased wealth also has an impact from a product point of view, as the increased re-allocation of assets in the region should be captured in local products to further boost economic development and local financial market liquidity. The success of local products (e.g. Sukuks and other Sharia-compliant structures as well as local REITs) indicates that there is a strong demand to invest in the region and to do this using local structures. If asset managers manage to successfully respond to that demand by creating innovative products, this will eventually lead to a greater diversity in asset pools, and thus allow the financial centers to increase their maturity and their contribution to overall economic development.

# Investment management





# Equilibrium in the operating models of Luxembourg management companies

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Asset management has changed considerably over the past years and is progressively recovering since the financial and economic crisis that severely impacted the global economy back in 2008.

The wait-out position defensively adopted by investors since the very beginning of the crisis caused, among other consequences, a decrease in tax revenues in all jurisdictions. Consequently, supranational institutions, governments and regulators had no choice but to respond with strong measures aimed at reinstalling a higher level of confidence that the market needed to get capital flows circulating again.





### Historical background and context

Investor protection has always been a priority for legislators, regulators and investors, since confidence is, in essence, a key driver in the investment management industry. And Luxembourg did not miss this opportunity.

Since the very first UCITS Directive, dating back to the late 80s, the UCITS regulatory framework has set the gold standard in terms of investor protection by defining types of eligible assets, investment diversification requirements, risk management, monitoring and supervision of delegates, asset protection and transparency requirements in relation to investors.

This regulatory framework also paved the way for cross-border distribution of UCITS funds throughout the European Union.

While UCITS Directives set the standards, they needed to be transposed into national laws and allow the Member States some degree of flexibility in designing these. Luxembourg seized this opportunity at a very early stage and, thanks to this foresight, nowadays, Luxembourg has the most advanced and versatile set of laws governing regulated investment funds.

Figure 1: Funds, sub-funds and net assets

End of period	TOTAL			OF WHICH		
	Number of funds <sup>1</sup>	Number of fund units <sup>4</sup>	Net Assets (€ millions)	Number of umbrella funds <sup>2</sup>	Number of sub-funds <sup>3</sup>	Net assets of umbrella funds (€ millions)
2005	2,060	8 497	1,525,208	1,298	7,735	1,341,411
2006	2,238	9 473	1,844,850	1,387	8,622	1,639,559
2007	2,868	11 115	2,059,395	1,688	9,935	1,812,442
2008	3,371	12 325	1,559,653	2,019	10,973	1,349,898
2009	3,463	12 232	1,840,993	2,108	10,877	1,628,125
2010	3,667	12 937	2,198,994	2,302	11,572	1,979,524
2011	3,845	13 294	2,096,512	2,427	11,876	1,881,506
2012	3,841	13 420	2,383,826	2,462	12,041	2,155,437
2013	3,902	13 685	2,615,363	2,529	12,312	2,384,349
2014	3,905	13 849	3,094,987	2,538	12,482	2,845,114
Jan 2015	3,885	13,864	3,277,013	2,521	12,500	3,017,822
Feb 2015	3,893	13,902	3,403,866	2,524	12,533	3,138,666
Mar 2015	3,888	13,910	3,524,793	2,523	12,545	3,250,443

(4)=(1) - (2) + (3)

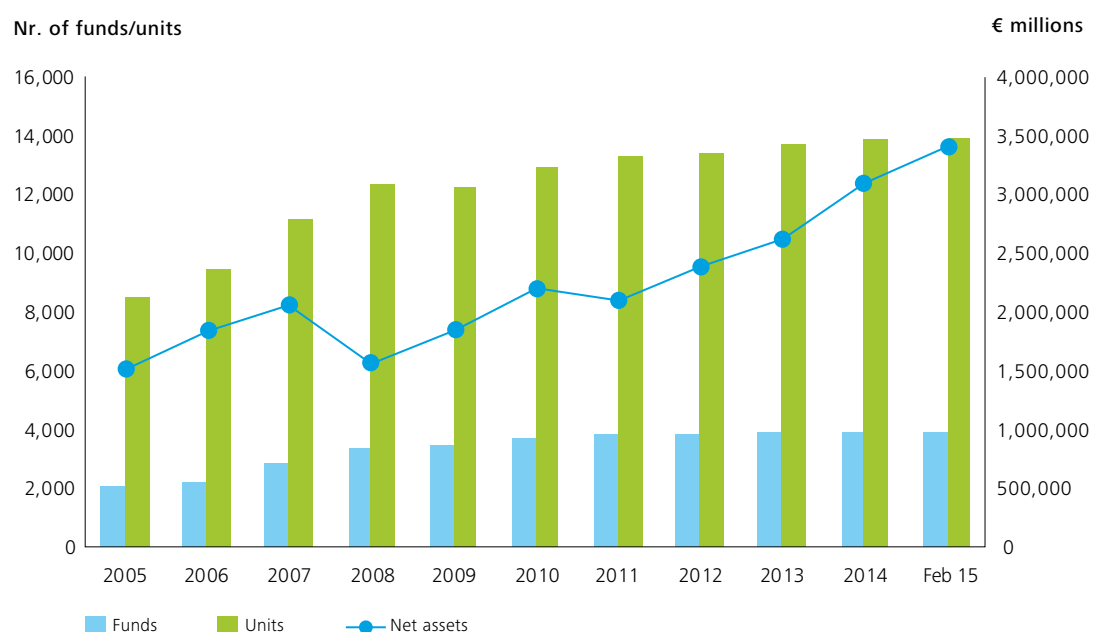
Source: CSSF

On top of this important legal framework, the Luxembourg regulator ("*Commission de Surveillance du Secteur Financier*" or "*CSSF*") plays a key role as part of its prudential supervision prerogatives, safeguarding the quality and stability of the Luxembourg financial sector. The CSSF issues additional binding memos (Circulars) and actively supervises regulated entities, collects and analyses data and conducts on-site inspections.

As a consequence, the investment management industry (both for UCITS and AIFs) has been very successful in Luxembourg over the last decade.

While UCITS Directives set the standards, they needed to be transposed into national laws and allow the Member States some degree of flexibility in designing those

Figure 2: Evolution of the investment management industry (2005 - 2015)



Source: CSSF

### Investment management – Luxembourg operating model

Luxembourg has clearly established itself as the domicile of choice for investment funds. The core element of a fund setup is the Luxembourg management company, and it is important to understand its operating model and core functions, which essentially cover:

- Investment management (the definition of the investment strategy and the day-to-day management of the fund)
- Pricing and valuation of assets
- Regulatory compliance monitoring
- Maintenance of the register of investors, distribution of income and processing of share issues and redemptions
- Distribution, sales, marketing or fund raising
- Conducting initial and ongoing due diligence on entities to which functions of the management company have been outsourced
- Ensuring risk management, permanent compliance and an internal audit function

The management company may also render some ancillary services to other group entities.

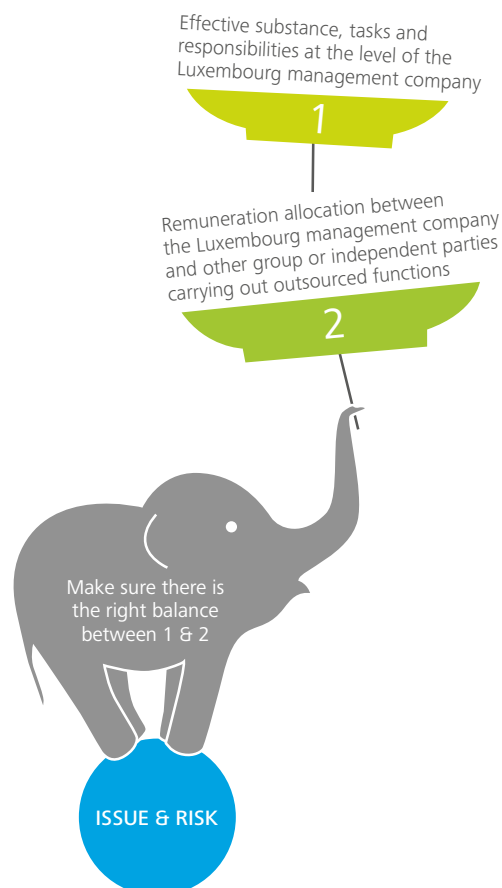
As a common feature, most Luxembourg management companies follow a semi- or fully decentralized operating model, whereby some core functions are outsourced to related entities within their group or to third parties. On the contrary, supervision and control are functions which can never be outsourced by a Luxembourg management company.

In terms of risks, the management company remains responsible and as such is exposed to liability risk even if core functions are outsourced. Accordingly, it is legally required and in the interest of the management company to supervise and perform due diligence on these outsourced functions.

In the past, a Luxembourg management company which had outsourced core functions (while keeping risk management, supervision and control at its level) was sometimes mistakenly not recognized as adding real value given its functional profile, and thus had little weight in the distribution of revenues derived from the investment management activity. However, this point of view is at odds with Luxembourg Law and regulatory prerequisites that require incremental substance and resources at the level of the management company itself, in line with the activities covered by the management company. For this reason, a Luxembourg management company must not only play its role, but also be remunerated proportionally to the functions, resources and risks it is liable for in Luxembourg.

### Issue & risk

Consequently, it is of utmost importance to make sure there is the right balance between:



Actually, the right balance may be derived from three different categories of requirements, which are highly interactive with each other:

*Regulatory requirements*

Substance as well as organizational requirements impacting Luxembourg management companies are strengthened following the implementation of CSSF circular 12/546 and the AIFM directive. Further requirements are expected with forthcoming additional regulations (UCITS V, ESMA guidelines on compliance function, MiFID II).

Regulatory requirements are highly integrated with transfer pricing since the substance required within the operating model of a Luxembourg management company cannot be in breach of the transfer pricing considerations set out below.

The key regulatory requirements as of today can be summarized as follows:

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A management company is remunerated by means of the fee received from the fund to cover all the core functions it carries out





### Transfer pricing

Each of the activities involved in the investment management value chain within a group gives rise to transfer pricing. A management company is remunerated by means of the fee received from the fund to cover all the core functions it carries out.

In case functions are outsourced to group parties, these should be remunerated in turn by the management company on an arm's length basis as independent parties would have agreed upon in similar circumstances. Therefore, it is essential to have a clear view of the functional profile at stake, i.e. the functions, assets (to be understood as the resources used to run the business such as experience and knowledgeable staff, conducting officers for example), and risks respectively shared by the management company and these parties in proportion to their contribution to the overall value creation process.

In terms of transfer pricing documentation, article 171 (3) of the Luxembourg income tax law as amended as from 1 January 2015 clarifies that any Luxembourg taxpayer carrying out intragroup transactions must be able to deliver, upon request, the appropriate transfer pricing documentation (e.g. transfer pricing report) demonstrating that remuneration applied to related party transactions (e.g. outsourced services) are arm's length transactions.

### Tax

The tax debate around the substance required within operating models of Luxembourg management companies is twofold, since both direct tax and VAT need to be considered.

#### Direct tax

With respect to the relationship with other countries, in case the required substance and transfer pricing principles would not be consistently met in Luxembourg (as it would be the case if a function would not be supported by the relevant level of substance or if it would not be properly remunerated), there is a risk that foreign authorities would simply deny the existence of the Luxembourg management company and consider that:

- The investment funds are effectively managed in another jurisdiction
- The commission flows between the funds and the parties involved in their management would be fully taxed in this jurisdiction without recognizing value-added at the level of the management company

**Hence, Luxembourg management companies must ensure that:**

- The substance, functional profile and remuneration are correlated
- The transfer pricing documentation requirements are respected in order to be able to respond to enquiries made by Luxembourg or foreign tax authorities and avoid a direct tax adjustment in case the remuneration is not at arm's length

Taking all efforts to reach upfront compliance with transfer pricing shall provide a valuable comfort to the management company regarding the level of taxable income.

## VAT

A clear understanding of the functions and flows may also have VAT implications, such as supporting the benefit of a VAT exemption on management services rendered to the investment vehicles eligible to such a VAT exemption, thereby also helping to manage the VAT position and potential VAT costs of the management companies.

As the management companies and the funds cannot (or only to a small extent) recover any input VAT paid to their suppliers, the operating model driven by economic constraints, regulatory requirements and transfer pricing policies must also be set up and considered in light of the potential VAT implications, which need to be carefully managed.

Effectively, although the VAT Directive implemented in the 28 EU Member States stipulates that the “management of special investment funds” is VAT exempt, slight substantial differences of interpretation between Member States sometimes remain in respect of either the “VAT” meaning of “management” of funds or the definition of the eligible investment vehicles to such VAT exemptions.

It is therefore important that the various functions outsourced by the management companies to affiliated entities or any third party entities are well defined and documented to sustain the benefit of a VAT exemption when the final recipient is an investment vehicle eligible for such an exemption in the country where the fund is located.

VAT-awareness is increasingly crucial in a cross-border environment where, as mentioned above, the VAT rules can be interpreted slightly differently and where the various entities located in different EU Member States have to deal locally with their local VAT reporting requirements. Specifically, this entails completing the European sales lists for intra-community services only when the latter are taxable in the country of the recipient, or to decide to what extent the corresponding turnover impacts, positively or negatively, their own right to recover the corresponding input VAT paid to their suppliers.

Even in the case where the affiliated entities would have to deal with VAT taxable services such as pure technical functions like IT support functions, it is recommended to identify these services and their corresponding considerations in advance, to plan the respective VAT liability in each entity that could impact a budget, a margin or any expense ratio.

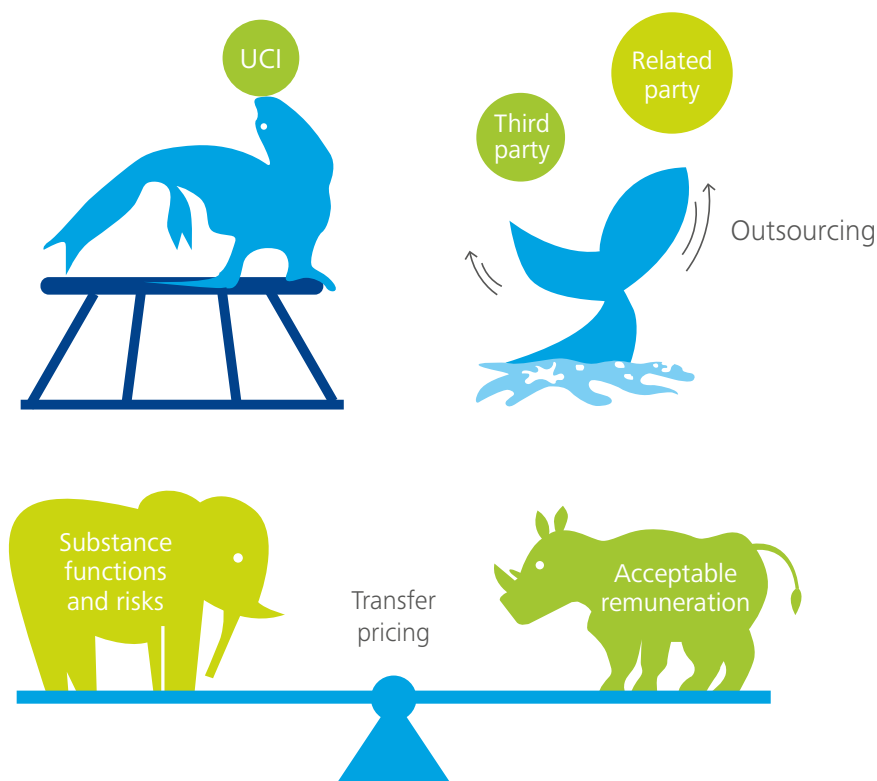
Based on the above, any change within the functions justified for regulatory or transfer pricing reasons could imply VAT consequences that would have to be anticipated in advance or at the same time, in any case before the implementation of any new operating model within the management company structure.



### Ask yourself the right questions:

Regulatory requirements	Transfer pricing	Tax
<ul style="list-style-type: none"> <li>• What will be the key impacts of the incompatibility regime on the organizational structure?</li> <li>• How to ensure that Human Resources meet the new qualification requirements?</li> <li>• How to review the delegation and sub-delegation models with regards to reporting, due diligence and supervision?</li> <li>• How to address stringent requirements on the sharing of resources at the management company level (experience, knowledge, availability, etc.)?</li> <li>• What are the proportionality conditions on derogations to substance requirements?</li> <li>• How to anticipate the sanction regime under UCITS V and strengthen your control framework and oversight?</li> </ul>	<ul style="list-style-type: none"> <li>• Are there intragroup transactions in your structure that will raise transfer pricing issues?</li> <li>• Is the remuneration applied at arm's length?</li> <li>• What risks is your institution facing if it is non-compliant with transfer pricing rules or documentation?</li> <li>• Is your (existing) group transfer pricing policy compliant with the Luxembourg law?</li> <li>• How to ensure that the current distribution model remuneration is sustainable tax-wise and compliant with transfer pricing regulations applicable in Luxembourg and abroad?</li> </ul>	<ul style="list-style-type: none"> <li>• Are you ready today to address and proactively respond to a request from tax authorities on transfer pricing?</li> <li>• Are relevant service agreements drafted appropriately so as to support the benefit of a VAT exemption when justified?</li> <li>• Is the current fee structuring appropriately anticipated on the VAT side?</li> </ul>

Figure 3: ManCo operating model, keep the balance right



### Conclusion

Regulatory requirements as well as transfer pricing rules are requiring taxpayers to align the level of their remuneration with the substance within their operating model.

Substance and transfer pricing have thus become a top priority for jurisdictions since they help ascertain tax positions of both administration and taxpayers locally (and indirectly on a cross-border scale) based on a fair and acceptable allocation of revenues on an intragroup basis.

We truly believe that actively anticipating the regulatory, transfer pricing and tax challenges within each specific operating model today will give a clear and positive message to the market and to investors, by reinforcing Luxembourg's reputation as a stable place for growth within the investment management industry.

After all, this is a matter of equilibrium!





# MiFID II

## To protect and to serve, but at what cost?

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While the primary objectives of the initial Markets in Financial Instruments Directive (MiFID) were to increase the competition, improve investor protection and allow EU passporting, the MiFID II package now introduces a range of measures aimed at addressing the consequences of MiFID I and issues raised by the financial crisis, such as making financial markets more efficient, resilient and transparent, improving investor protection, as well as addressing commitments made by the G20 in Pittsburgh (2009) on these topics. There is a need for modernization, as technological advancements and the changing complexity of financial markets have outpaced the provisions of the original directive.

After intense discussions, the new MiFID II package was adopted by the European Parliament (EP) on 15 April 2014. By the end of 2016, all 28 EU Member States will be on the same playing field.

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The revisions to MiFID I will have a significant impact on both the business strategy and the operational processes implemented by firms



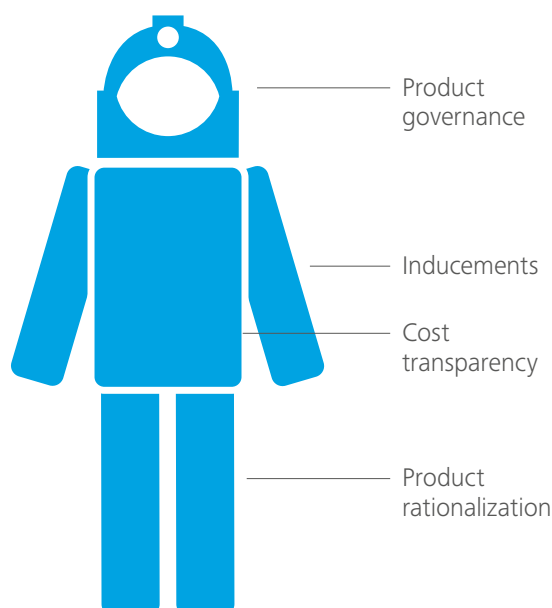
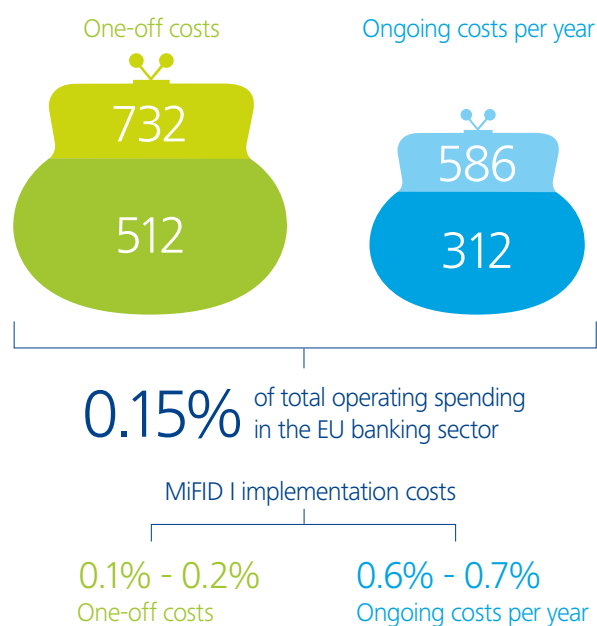
The revisions to MiFID I will have a **significant impact on both the business strategy and the operational processes** implemented by firms. The challenge will be to turn those effects into opportunities; however, this will come at a certain cost at first, even just to comply.

Although the European commission has estimated the initial costs of the MiFID II implementation between €512 million and €732 million for the whole European banking sector, these costs only include the compliance costs, which may obviously vary from one financial institution to the next, depending on the business model and strategic ambitions of each one. Although the directive only applies to MiFID firms, fund management companies will likely also incur costs to enable the banking distributors of their funds to fulfill their requirements.

The cost and effort it will take to implement MiFID II features need to be carefully addressed and planned. Indeed, this compliance cost will create a heavier burden on smaller firms and could become a barrier to entering the market, or jeopardize their existing market position.

#### Key challenges for the fund industry

The impact of MiFID II will vary from one business model to the next. The fund industry may expect consequences in the following areas:



### Product governance—New obligations for both manufacturers and distributors

MiFID II introduces extensive product governance obligations for both manufacturers and distributors of investment products. In short, manufacturers will need to take reasonable steps to ensure target market and end clients are identified and reached. In other words, they will need to put a strong product governance and product approval process in place and will have to perform ongoing reviews of those products.

For the sake of improving the understanding of the investment products, manufacturers will have to ensure distributors have access to all necessary documentation and information so that they themselves can make sure those products reach the targeted markets and end clients.

Client segmentation is likely to be challenging for firms as it seems that ESMA will not provide any further guidance on how to identify those target markets. In addition, the notions of the target market may differ from one firm or country to another; e.g. firms may have varying definitions of “European clients”.

Manufacturers designing products that are distributed through other investment firms should identify the target market on a “theoretical basis”. Distributors should use the manufacturers’ target market assessment (unless it is unavailable i.e. in the event the manufacturer is not subject to MiFID) together with existing information on their clients to identify their own target market for a product. If the investment firm acts as both manufacturer and distributor there is no need to duplicate the target market assessment and distribution strategy exercise, although the firm should ensure it undertakes these activities in sufficient detail to meet both the manufacturer and distributor obligations.



A key challenge will be managing this dual responsibility between manufacturers and distributors, and ensuring that arrangements are in place to exchange the necessary information and documentation.

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## MiFID II introduces extensive product governance obligations for both manufacturers and distributors of investment products





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## The cost and effort it will take to implement MiFID II features need to be carefully addressed and planned

### **Inducement will be allowed under strict conditions**

In its Technical Advice, released in December 2014, the ESMA clarified that it will not opt for a full ban on inducements as was the case in the UK and the Netherlands. Nevertheless, the conditions under which they will be allowed will be strictly monitored and reported. Monetary and non-monetary benefits only being allowed for non-independent advice, independent advisers will have to start charging—and disclosing—an explicit fee for advisory as one possible way to compensate for the loss of inducement.

Needless to say, this shift will have to be carefully planned and well-communicated to avoid client dissatisfaction and change of advisers.

The trend we see now is that more and more advisers will likely decide to go for non-independent status offering a range of financial products from a limited number of product manufacturers. Many advisers are keen to explore this non-independent set-up, that will probably result in less impact on their models and potentially more focus on in-house products.



### **New charging structure may impact the customers' choice**

Retail investors tend to prefer a commission model rather than a servicing fee model, which has complicated the move toward fee models in markets that have banned commissions (e.g. UK and NL) and may result in a large underserved population. This preference for a commission model often arises from a lack of understanding of the fees charged through inducements or commissions. Often, investors think financial advice paid through inducements is free. Investors also often fail to understand just how much they are paying advisers, whether they are operating under a commission or a flat-fee structure.

Communication of a new charging model will have to be carefully planned, well before the implementation in Q1 2017. This could be done, for example, through regular newsletters, distribution of reading material to clients, description of the benefits of advisory through a real case study, deconstruction of the advice into sub-services (meeting, call, online information tool, etc.), providing reports in hard copy, making it more tangible to the clients.

The care advisers give to their clients will be more important than ever in this new competitive environment, in which all adviser service offerings and related fees will be more visible to investors. Take the UK RDR impact on the IFAs as an example: there has been a decrease of 10,000 Independent Financial Advisers (IFAs) since 2010. Even if this skimmed off a good layer of the non-competent advisers, this phenomenon cannot be disregarded.

### **Rationalization and standardization of products can be expected**

In this context, potential rationalization and standardization of products is likely to happen. Manufacturers will need to ensure that the products are distributed to the target market and that the products meet the target clients' needs. On top of that, regular performance reviews have to be performed on the products so that the distributors can assess whether they still fit with their clients' profiles.

We view this work as an opportunity for firms to rethink their model and boost their profitability through cost reduction, to continue to operate profitably. The requirement to better manage the increased flow of information shared between the investment firms and distributors regarding details on the product will probably see a rise in document dissemination platform service offerings.

### **What's next?**

It is now time for the industry (credit institutions, investment firms, asset management) to assess the first strategic and operational impacts, by estimating which of their revenue streams is at risk and how this loss of revenue can be compensated in their value chain.

### **What you can start doing:**

- Organize training sessions to raise your teams' awareness of the MiFID II challenges
- Assess impacts of inducement ban on revenues
- Identify P&L optimization opportunities on services, products and client mix considering the impact of MiFID II
- Identify links and synergies with other upcoming regulations or market initiatives impacting the fund distribution models (e.g. AML IV, T2S, PRIIPS)



# Le Freeport Luxembourg creates new perspectives for the Luxembourg economy

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## Le Freeport Luxembourg will act as a catalyst for services offerings in the financial, logistics, ICT, and cultural sectors.

Behind the scenes, Deloitte worked for seven years to lay the foundation for Le Freeport Luxembourg ([www.luxfreeport.lu](http://www.luxfreeport.lu)), as part of the unique Art & Finance initiative. *"We felt that by making the bridge between the art market and finance, there would be quite a lot of opportunities for Luxembourg"*, states Yves Francis, CEO of Deloitte Luxembourg. We aim at creating a strong link between the world of art and the financial sector, and position Luxembourg as an international hub for Art & Finance. For the Freeport project, we carried out extensive fiscal and strategic work at our own cost and helped the Government through our expertise in tax and VAT related matters.

### A unique diversification tool

First of its kind in the European Union, *"Le Freeport Luxembourg has been inaugurated as announced two years ago on 17 September 2014 at 5 p.m. with the presence of many personalities. Being able to maintain the planned schedule is already a big success,"* said

David Arendt, the CEO of Le Freeport. Le Freeport Luxembourg offers the best worldwide high tech logistics hub for managing, handling, storing—without limitation in time—and trading fine arts, fine wines, precious metals, jewels, and other valuables, under a regime of suspension of VAT and customs duties at the heart of Europe. It is a neutral platform operated by specialist forwarders and logistics companies active in the transportation, handling and storage of valuable goods. The operators are duly licensed by the Luxembourg Customs Authorities and accepted by The Luxembourg Freeport Management Company S.A.

The freeport concept is not new but the specificity of Le Freeport Luxembourg is its specialization in value goods. From the very beginning, it was considered to be not only a storage space but a strategic project with long-term benefits for the Luxembourg economy and its diversification.



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## Wealthy investors are looking for specialized information and deeper levels of advice on tangible assets

For Luxembourg's Deputy Prime Minister and Minister of Economy, Etienne Schneider, *"Le Freeport Luxembourg will significantly contribute to the diversification of the Luxembourg economy, enriching and complementing both its logistics platform and its financial center,"* adding a new dimension to it and making it more diverse. Pierre Gramegna, Luxembourg's Minister of Finance adds, *"The main reason why it was important and wise to go in that direction is that Le Freeport blends very well with the Luxembourg landscape. One of the key priorities of the government is to continue to diversify our financial sector."* **Le Freeport Luxembourg will act as a catalyst for services offerings in the financial, logistics, ICT, and cultural sectors.**

### A unique ecosystem

Located next to the Cargo center at the airport of Luxembourg, which is the fifth largest air cargo hub in Europe, Le Freeport Luxembourg offers direct air and land access and enables value goods to be delivered straight from the tarmac without any road transport costs and risks. Furthermore, Luxembourg's airport is a very convenient landing spot for private jets. Le Freeport is an integrated solution that offers a wide range of services such as private showrooms, a photo studio to include art pieces in catalogues, art valuation, restoration and insurance brokerage, customs handling, crafting, shipping, framing, etc. *"We wanted to create a group competence center around the Freeport and we have reached this goal. The restoration room is operational, and we found an operator for the laboratory. Several professionals have settled in the Freeport and offer services in art valuation, art advisory, insurance brokerage, tax and customs advisory, or art monetization. I still receive requests to rent offices, including from law firms and fund managers",* explains David Arendt.

The regime of suspension of VAT and customs duties applies as long as the goods remain in Le Freeport Luxembourg, which is under the supervision of the Luxembourg Customs Authorities. The latter has unlimited access and right to inspect all goods entering and exiting the storage. David Arendt, underlines that *"it is important to keep in mind that the system of transparency and traceability with the Customs Authorities handling the Freeport is going beyond European customs requirements and is a real model. On a regulatory perspective in the global art market, we are already 5 to 10 years ahead."*

However, goods can leave the storage without losing their tax advantages under specific conditions during a limited time, for an exhibition in a museum or an art fair, for instance. The Freeport is not a place where art should stay out of the world but where it should live, as shown by the existence of showrooms and conference rooms inside Le Freeport.

### A competitive tool for the Luxembourg financial sector

Le Freeport aims at contributing to the development of a new service offerings for financial sector professionals, including private bankers, insurance companies, family offices, depository banks and asset managers, who could act as custodians for their customers' tangible assets or investment structures investing in physical assets that could be stored locally and benefit from the same jurisdiction as the structure domiciled in Luxembourg.

As pointed out in Deloitte and EY's joint white paper *Wealth Management and Private Banking – Connecting with clients and reinventing the value proposition*, wealth managers and private bankers must reinvent their value proposition in response to significant industry pressure and shifts in client demands.

The traditional Ultra High-Net-Worth Individuals (UHNWI) are now asking for a higher level of personalization and customized products and services. Standardized offerings are no longer sufficient to satisfy sophisticated client demands that go beyond investment portfolio management.

In such a context, Le Freeport Luxembourg can clearly offer Luxembourg and foreign financial institutions the opportunity to develop a group competence center on value goods in Luxembourg. Financial players based in Luxembourg can indeed leverage the unique ecosystem of Le Freeport to become the center of excellence for value goods, not only to serve their own clients but also those of other entities of the group they belong to, located abroad.

David Arendt confirms the interest from the financial sector *"Wealth managers are very interested in Le Freeport. We constantly have visits from bankers and Professionals of the Financial Sector (PFS), and they often come with their clients. Then, it is up to our licensed operators to turn these visits into concrete business."*

People have always invested in emotional assets. The interesting trend is that wealthy individuals are increasingly viewing art and collectibles as serious real assets. They represent sizeable wealth for many UHNWI and—with the increase in worldwide wealth—even more wealth is allocated to collectible assets. Wealthy investors are looking for specialized information and deeper levels of advice on tangible assets. An increasing number of private banks are teaming up with experts to come up with an art market strategy beyond simply offering their clients access to art fairs and other concierge type services.

These trends create an opportunity for financial players to broaden the scope of their services. They can expand their service offering by integrating the concept of collectible assets into the overall asset allocation strategy to assure adequate liquidity, avoid over-exposure to risk, minimize income taxes and organize appropriate transmission to heirs or donations to charity. It is a complete new field, which provides room for innovation. It is also a complex subject, which requires high value-added services to support customers, such as legal, tax, wealth structuring, insurance, conservation, trading, etc., in line with the Luxembourg strategy to develop high value-added services.



### Ripple effects on the art sector, logistic sector and the ICT sector

Le Freeport Luxembourg addresses the demands of the globalized art world. For collectors and investors there is no better place to store, show and trade their artworks and other valuables. It can also turn Luxembourg into an attractive place for artists, galleries, international sales, art fairs and museums lacking space and enable exchanges between museums and collectors all over the world. Luxembourg could even position itself as an international hub for the preservation of the world cultural heritage, for instance museums exposed to specific risks like flooding or those located in politically unstable regions.

Le Freeport also represents a great opportunity for the logistics and transport sectors, and Cargolux could strengthen its leading position in art transportation. The Freeport will have a lasting positive impact on the global development of the airport zone and specialized transport services.

For the ICT sector, online businesses such as online art marketplaces, online auctions, online collection management tools and online platforms for art secured lending could choose Luxembourg as their preferred location to serve Europe and beyond, even more so thanks to the recent investments in technological infrastructure.

### Winning market share

*"Le Freeport became operational during the first week of November 2014. The main reason for this delay was the complexity of the homologation procedure for licensed operators, which took longer than expected. Indeed, the Customs Authorities' require to be electronically informed about all entries and exits in and out of Le Freeport, all in real time with specific software requirements. It implied a long and expensive*

*software update for candidates. The goods stored in the Freeport since November are mainly art, fine wine and precious metals. There are also many requests concerning collection cars but nothing has been set in stone yet", explains David Arendt.*

At this stage, over 60 percent of the storage capacity has been rented out but David Arendt also recognizes that a lot remains to be accomplished. *"The clients of freeports tend to go to well-known Swiss freeports, especially the one in Geneva. We still have a huge communication plan to put in place to make collectors and investors and their advisors aware of our service offering".*

Le Freeport clearly offers a competitive advantage. Nevertheless, recently it has had to deal with the intense media coverage of Yves Bouvier, the main investor of the Freeport and chairman of EuroAsia SA, a Swiss leader in the management of objects of great value. EuroAsia SA owns the Singapore freeport and is also the largest private owner of the Geneva Freeport.

On this particular point, David Arendt comments *"The accusations against Yves Bouvier and prosecutions against him in Monaco, Singapore and Hong Kong have had a negative impact on our image, despite the fact that Yves Bouvier is not at all involved in the Freeport operations. He considered it appropriate to pull out from the governance of the managing company until his innocence is established. Moreover, two independent administrators have joined the Board of Directors of the managing company; they are well-known personalities of Luxembourg's political and financial life. Further changes may be announced in due course."*



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Le Freeport also represents a great opportunity for the logistics and transport sectors, and Cargolux could strengthen its leading position in art transportation

#### **Conclusion**

Le Freeport Luxembourg has already started to contribute to the diversification of Luxembourg's economy. The Freeport is now part of the economic landscape and shows a strong innovation capacity to attract new talents for the creation and development of new activities in various key sectors of the Luxembourg economy.





# Crowdfunding, an emerging market in Europe?

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### What is crowdfunding?

Crowdfunding is a means of fundraising from the crowd, generally by using the internet.

Crowdfunding is becoming an increasingly popular way to connect entrepreneurs in need of financing, with investors—mostly retail investors—in search of various forms of returns ranging from pure profit to impact investing and even non-financial returns.

Historically, entrepreneurs used to face funding challenges when financing their start-ups as banks were not supportive of their innovative ideas. Often, their funding capacity was limited to personal savings complemented by whatever could be collected from direct family members and close relationships.

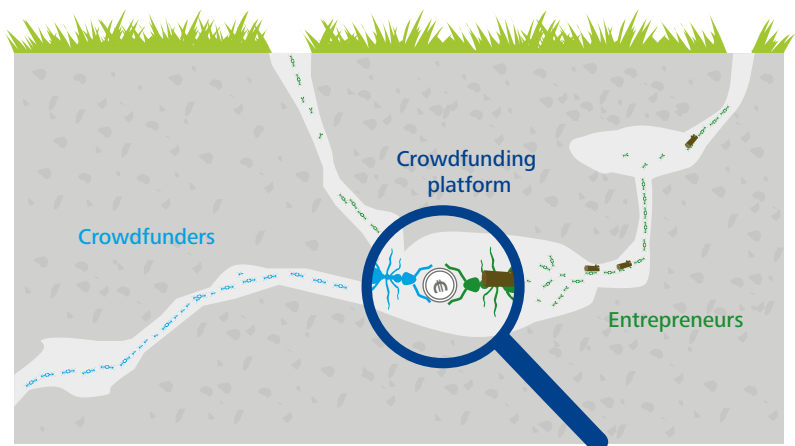
The development of the internet across our society has enhanced and accelerated communication and connections between people and communities sharing similar ideas. Entrepreneurs quickly understood its benefits and started advertising their innovative ideas through the net. Communicating about a project through the internet and financing the project through alternative funding channels and mass markets became a reality.

However, the size and broadness of the web quickly became a challenge for entrepreneurs desperately searching for financing means: how to successfully reach investors interested in their niche projects? Thus, the first crowdfunding platform appeared on the net.

Crowdfunding platforms connect crowdfunders (investors) and entrepreneurs through dedicated websites such as Kickstarter, SmartAngels, MyMicroInvest, Crowdcube, ... and they are booming across the globe.

Why are they so successful? Probably because they offer, at a very low entry cost, an easy alternative to traditional financing and investing. Investors can choose projects they like, projects they feel emotionally connected to and decide to sponsor them.

Crowdfunding is furthermore strongly connected to social and impact investing.



### How to categorize crowdfunding activities?

The first category of crowdfunding activities is donation, by far the oldest and most widespread one. Crowdfunders finance a specific project with no financial return or capital reimbursement expectations. Their aim is to contribute to a specific or sustainable project in the society. These are often run by NGOs or social organizations. Occasionally, a non-financial return is granted to the generous crowdfunders as a token of appreciation. This form of crowdfunding is lightly regulated.

The second category is called the lending model. Crowdfunders lend money through a platform and thereby finance entrepreneurs' projects. The loans may or may not carry interest and are theoretically reimbursed at maturity. This lending model is the most common crowdfunding model involving financial return. It is not formally regulated but falls naturally under the European Banking Authority regulations and policies.

The third and last category is called the equity model. Crowdfunders invest their money in the equity of a project through a crowdfunding platform. If the project performs well, they might get dividends and make a profit on the sale of their shares of the company at a later stage. It is not formally regulated and triggers higher risks for the crowdfunders. The European Securities and Markets Authority (ESMA) has recently published an Advice and an Opinion on investment-based crowdfunding (the equity model).

### What is the European crowdfunding market like?

According to the European Crowdfunding Network (ECN) Review of Crowdfunding Regulation dated October 2013: *"The rise of crowdfunding over the past decade is a result of the ongoing digitalization of processes and communication in our society, with easy access to high-speed internet and digital devices."*

Crowdfunding has recently been moved to the forefront in the discussion on access to finance. This is a result of the economic crisis and the associated market failures of the incumbent financial services industry, which provides financing to Small- and Medium-sized Enterprises (SMEs).

Europeans save their money rather than assume risk by investing it in small enterprises, and they admire established institutions rather than the entrepreneurs who built them. According to statistics, some 30 percent of SMEs face liquidity problems and only 30 percent of SMEs have access to bank credit at any given time. Plus, the availability of bank loans for SMEs has declined over recent years, while collateral requirements have increased. Still, SMEs are the main contributors to job creation and represent around 67 percent of all jobs in Europe.

This drastic lack of funding for SMEs has a visible impact on Europe's economy. It is the main reason why we are witnessing a political discussion on the topic and why crowdfunding is expanding.

ECN is the lobbying group of crowdfunders and believes in the opportunities that crowdfunding can offer to the European economy.

We witnessed this belief at the ECN annual general meeting in Paris in November 2014. This event gathered hundreds of crowdfunders and platform representatives from all over Europe, each with a strong motivation to promote and push this emerging industry a step ahead. This time, market regulators, financial lawyers, venture capital firms and angel investors also attended the conference.

Is crowdfunding a booming alternative to the existing finance market? The reply to this question is probably positive, if one looks at the crowdfunding initiatives that are emerging across Europe. In France, for example, there are more than a hundred crowdfunding platforms collecting almost €100 million every year, mainly through lending. The United Kingdom market is also very advanced with almost 100 platforms collecting annually about €1 billion, mainly through lending and donation.

Moreover, these amounts seem to double every year.





### Regulation or no regulation?

That's the dilemma.

There is a lot of criticism around the incompatibility of the existing European financial industry regulations and that of crowdfunding, which are almost non-existent at a European level so far. To mitigate this, countries such as France have implemented their own regulation to support the industry through a "*décret sur le financement participatif*" facilitating equity and lending crowdfunding. The UK is also utilizing a mix of existing regulation on collective investment schemes for equity crowdfunding and some new tailor-made regulation for the lending category. Similar initiatives have taken place in Italy and other European countries. These will not facilitate the harmonization of the regulation across Europe, even if crowdfunders request facilities for European cross-border crowdfunding activities.

On one hand, size is critical to survive—so is scalability—and these will be enhanced with a European regulation. On the other hand, crowdfunding is today a business of proximity. Most initiatives are local, supported by local platforms for local entrepreneurs and local investors in their local languages.

### What is the feedback from ESMA on crowdfunding?

ESMA formally gave its feedback on investment-based crowdfunding (equity crowdfunding) in two publications in December 2014, an Opinion and an Advice.

ESMA believes that crowdfunding has to be taken seriously. It is considered to be a new type of business that tends to be organised into several continuously evolving business models. The European financial services rules were not designed with crowdfunding in mind, and it is difficult to map crowdfunding platform activities with European rules as activities vary. It is a fact that European Member States address crowdfunding either by fitting it as much as possible within existing rules or by adapting it on an ad hoc local basis.

There are many risks arising from investment-based crowdfunding such as the size of most projects, as they are financing small companies with a potential high failure rate. The securities issued by these small companies are generally unlisted and present significant risk for capital loss. They are either not liquid or are barely liquid.

Furthermore, the information available to investors prior to making an investment in a crowdfunding project is often limited and probably not sufficient for a sound and clear investment decision.

At a platform level, risks range from a conflict of interests between the crowdfunding project and the investors, to a platform failure if it administers client assets.

ESMA, however, considers that crowdfunding has strong potential for financing the real economy, and that it can widen the investment opportunities available to non-institutional investors.

Among others, the following European regulations may apply to crowdfunding: the Markets in Financial Instruments Directive (MiFID), the Alternative Investment Fund Managers Directive (AIFMD), the European Social Entrepreneurship Funds (EUSEF), the European Venture Capital Funds (EuVECA). But none of these regulations address the specificity of the crowdfunding industry.

### What about Luxembourg?

Interest in crowdfunding in Luxembourg is limited by two main factors: the size of the local market and the regulated Luxembourg finance and fund industries.

The size of the market is a key driver for the financial survival of a crowdfunding platform. Local initiatives that have emerged so far have struggled due to the small size of Luxembourg.

The Luxembourg finance and fund industries are very much mature, organized, and regulated, and they benefit under certain conditions from passporting facilities, which is what crowdfunding would be seeking in an ideal world. Their regulatory and operational costs are, however, not accessible and not affordable for the small investment projects driven by the crowdfunding market so far.

Luxembourg, however, presents a strong opportunity for crowdfunding platforms given its valuable experience as the European hub for investment management. Luxembourg could also become a hub for crowdfunding if a European regulation—incorporating passporting facilities—would arise.

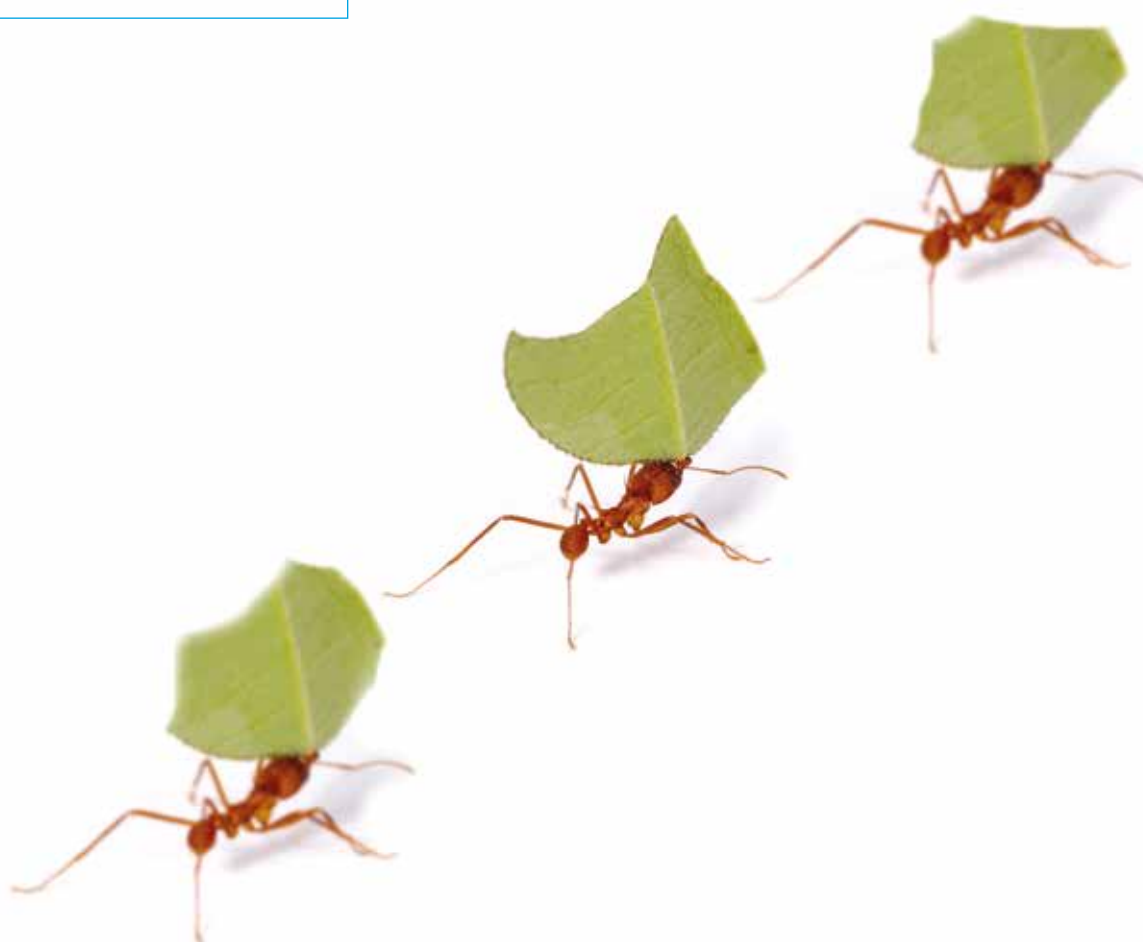
### Conclusion

Crowdfunding is a booming industry that expanded together with internet usage. It presents various models/categories such as donation and the lending and the equity models. ECN, the lobbying group of the crowdfunders and crowdfunding platforms, is organized and is pushing this industry forward but recognizes a lack of harmonization among European regulations for the moment. ESMA is of a similar opinion and formally expressed itself on the matter in 2014.

Luxembourg is looking for more European regulation for this industry and would probably position itself as a potential hub for platforms, leveraging its current financial and fund competencies.

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Interest in crowdfunding in Luxembourg is limited by two main factors: the size of the local market and the regulated Luxembourg finance and fund industries



# Maximization of the Finance function through Business Partnering

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## **The Finance function needs to evolve**

The finance function (Finance) stands at the crossfire of both internal and external challenges. External challenges are best described by the pursuit of efficiency and the related chase for cost reduction in the wake of the financial crisis in 2008. In parallel, internal challenges for Finance have increased due to various reasons such as the increasing need for faster financial reporting production coupled with a limited quality of data and the need for centralized, client-centric service models to respond to cost reduction as well as general efficiency and control pressures. These challenges lead to increasing pressures on Finance to create a high-performing business culture, while the function also experiences higher demands from the business to drive performance with increased focus on strategic advice and business insights.

Faced with these challenges, an urgent need for Finance to transform itself has emerged. The role of Finance is evolving from serving as accountant and controller to one of a trusted adviser who supports the business manager's strategic and operational decision-making by delivering value-adding insights. Although this transformation is necessary, the function still needs to comply with the more traditional role of Finance where the department's output is used to support board-level decision makers with analyses and facts. Leading businesses aspire to reduce the amount of time spent on transactional activities and financial reporting and planning—for example through ERP implementation, shared service centers, outsourcing and Business Intelligence investments—while maximizing the amount of time spent on activities, which are considered to bring the most value as decision support activities.



A refocus of efforts towards driving business and shareholder value, and providing the right environment to successfully create such value are demanding tasks. Many organizations are thus focusing on implementing strategies to provide a better environment for business partnering. This opportunity to redefine and invest in Finance business partnering has been further enhanced by the surge in quantity and variety of data available, commercial demands of new business models and opportunities presented by digital transformation. As a result, many organizations have already started to invest in and develop Finance business partnering capabilities.

#### **Finance executives are increasingly becoming strategic business partners**

Business partnering can be defined as the role that Finance undertakes to support and challenge the business in ensuring that the chosen business strategies deliver the required shareholder value at an acceptable level of risk. Thus, the business partner supports the Finance function in the evolution towards a role that focusses on delivering decision support aimed at value creation, rather than solely concentrating on transactional, reporting, and planning activities dedicated to value preservation. As such, a business partner not only analyzes the past information but also looks at the future through simulations and scenario analysis during planning, budgeting, and forecasting exercises. He develops and maintains sustainable relationships with the business units, advises on the

value drivers, and formulates sound recommendations that lead to better steering of business decisions. Business partnering plays a crucial role across the organization by delivering timely, relevant and insightful management information to the business, allowing the best decisions possible to be made.

The shift in the center of gravity of Finance towards strategic aspects suits the business partnering model very well. To support strategic business decisions, it is important to identify the people with the right perspectives to solve the problem, to develop a common understanding of the issues, to create the environment that will foster creative collaboration and to find the right timing. By enabling increased interactions with business units, the business partnering model creates a favorable environment for the above-mentioned prerequisites. It also supports the three stages of strategic decision making: building understanding, shaping choices, and making decisions.

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## The shift in the center of gravity of Finance towards strategic aspects suits the business partnering model very well



The Finance business partner thus acts as an informed challenger and adviser who ensures the alignment between profitability, strategy as well as the capital and risk aspects. The business partner brings additional value to the organization's value drivers compared to the traditional Finance executive.

- **Revenue growth:** The business partner plays an active role in enhancing revenue, either business-specific, or investment-related through sound judgment on customer segmentation, product portfolio and investment management techniques.
- **Operating margin:** The business partner challenges and advises the business units to improve their margin by clarifying the impacts of specific claims and other cost fluctuations on the business profitability.
- **Capital and risk management:** The business partner supports the business to integrate risk impacts (liquidity, credit, market, operational) in its decision making process, analyzing the balance sheet impacts of a new or existing product e.g., in terms of capital consumption and reserve formation.
- **Strategy effectiveness:** The business partner challenges the initiatives taken by the business units and assesses their alignment to the strategic ambitions set by the company as well as the market trends and actions taken by competitors. The business partner also facilitates the linkage of business performance measures with financial outcomes.

Making the transition from a traditional, mainly back-office function to a more strategic, business-facing, front-office oriented role is not always an easy endeavor and requires commitment and effort to achieve. This critical transformation process impacts the organization as a whole and does not ensure per se that finance business partnering capabilities will translate into tangible strategic benefits, which are meaningful and value-adding to the organization. This may explain why CFOs need to think twice before selecting this organizational setup. Not all CFOs are prepared to invest a significant amount of Finance's resources and time in order to deliver business partnering capabilities.

### Finance business partnering requires adaptations

Changing Finance into a business partner organization poses barriers, as do all transformation processes, as it is rare that a consistent approach across the business is applied. This means that priority areas and activities cannot be clearly identified and that the financial return on any partnering investment is potentially undermined. By trying to tackle all opportunities at once, Finance will also find it harder to convince the business of the benefits they can bring. Focusing attention first on the delivery of partnering activity to a few high value opportunities can both test and prove the worth of such an objective.

In our view, Finance should strive to optimize its operational levers to deliver effectively and support the business in achieving its objectives. This can be achieved only through the creation of a favorable environment for the implementation of business partnering. That is why the Finance transformation process should mainly focus on four enablers:

1. **Finance organization**—The Finance organization often shows a high level of complexity, putting a burden on the communication between Finance and the business. Moreover, operational efficiency can be achieved by eliminating fragmented organizational models where similar tasks are performed by different teams. It can prove useful to design and implement a new target operating model which takes into account the focus on the business unit, while maintaining transversal knowledge of company figures. In addition, a single point of contact within Finance allows for streamlined communication with the business units.
2. **Policy and process**—In the business partnering model, strategic objectives are operationalized through integrated performance management processes. To do so, it is crucial to have solid financial processes that meet the new requirements and to establish organization-wide integrated planning and budgeting process. In addition, creating related governance structures will allow to properly promote

the strategic objectives of the company. To support this change, it is necessary to create transparency and to challenge the business and service providers in order to play an active role in cost management by optimizing the Finance cost base. Establishing service level agreements may also secure an agreed-upon quality standard of deliverables that will benefit both Finance and the business.

3. **Talent and people**—Assuming the role of business partner implies a strong focus on getting skilled business leaders on board. In order to be able to add value to the organization, investments need to be made to acquire and retain specialists with the necessary business skills as well as accounting and auditing skills. It is important to identify and stimulate the top talent, to broaden their skills and competencies, to create a new team of business partners through internal and external recruitment of new profiles as well as rotational assignments in the respective business organizations. This needs to be achieved while increasing the time spent on analytics and reporting through automation and organizational change.
4. **Systems and information management**—A well designed set of processes—enabled by a single, reliable source of data for reporting across systems—is critical for quality decision making, while automating key Finance processes will enable accurate reporting and analysis supporting the decision making process. Consequently, in order to leverage on the benefits of business partnering it is of paramount importance to develop new performance system solutions to ensure the production of correct financial data (“one single version of the truth”) and the flexibility to simulate projections. The centralization of the report generation within a clear governance structure providing standardized and certified reporting, supported by flexible modeling and reporting tools, should also be an objective.



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## Understanding where partnering effort will add the most value to the business, will enable the prioritization of activities where Finance can work with the business right from the start

### Now is the time

Within a challenging economic context, in which the path to profitable growth is unlikely to be straightforward, Finance business partners are in a unique position to help steer the business. The quantity of data available and the tools to turn that data into insight is enabling an unprecedented level of analytical and commercial input into decision-making. This gives the opportunity to CFOs and finance leaders to prove that they are able to effectively step into the role of strategic Finance business partner, and become a driver of change. While the journey to effective business partnering is based on continuous improvement and learning, there are some practical actions that can set the course:

**Clearly identify where Finance can add value to the business**—Set an agenda for business partnering to enable the business strategy, address obvious high value areas, and ensure that all value opportunities are reviewed over time (some of the quickest wins can come from areas that have not previously received any focus). Understanding where partnering effort will add the most value to the business, will enable the prioritization of activities where Finance can work with the business right from the start. This will also ensure agreement on the partnering role and secure immediate buy-in to the approach.

**Remove the hurdles to creating new value, and demonstrate the results**—Addressing each value area separately and undertake all that is necessary to obtain the insight and influence to deliver value creates a “virtuous circle” of belief in Finance’s ability for business partnering, both within the function as well as across the organization. Celebrating successes and highlighting role model behavior will help pave the way for the manner in which Finance wants to act as a strategic catalyst.

**Bolster improvement by addressing the structural enablers of financial capacity**—While immediate progress can be made, irrespective of the challenges, it is important to address the four fundamental enablers of financial capacity in order to sustain that progress. Insight tools, data quality, skills development and career progression opportunities are all necessary to maintain the motivation of good Finance partners. Identifying the gaps in these enablers and setting a clear, realistic and sustainable roadmap to address them over time will bolster Finance’s capability development over time.





# How to improve business performance thanks to a holistic follow-up of the CFO

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As corporations are exploring new ways of profitable growth in increasingly complex business environments, CFOs must reinvent their function and expand their scope of knowledge by using a three-dimensional framework of profitability assessment, ensuring that appropriate levels of performance measurement are available at corporate, product and client level.



In order to properly optimize corporate performance, today's CFOs should ensure that the firm's profitability effectively reflects the current and prospective performance at different levels of the organization. In doing so, CFOs should strengthen their in-depth view of their businesses and develop innovative reporting tools and analyses to support strategic decisions in complex and dynamic environments. The biggest challenge for CFOs is to go beyond the traditional costs and revenues approach, by developing a brand new three-dimensional analytic approaches of their corporation focusing on understanding their clients and products while keeping track of the nature of their costs and their overall profitability.

This requires CFOs to develop more business-focused skills in many areas of their organization and acquire a strong knowledge in operational performance, sales management and product portfolio management. Eventually, by developing this insider view of each area of their corporation, CFOs will increase their ability to deliver business managers and boards with tailored analyses. This process will ultimately reinforce the ability of corporations to implement more targeted strategic decisions and boost short- and long-term profitability.

Once these new performance indicators and objectives are established, CFOs should develop a clear road map of future initiatives and prioritize them, to efficiently improve corporate performance in a cost effective way. An efficient governance system should also be in place to empower leaders and gather the people that will ensure that targeted goals are met. It is also critical to conduct this three-dimensional profitability analysis on a regular basis (and not as a single exercise) in order to ensure that remediation actions are established and controlled, and can ultimately positively impact financial results.

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In order to properly optimize corporate performance, today's CFOs should ensure that the firm's profitability effectively reflects the current and prospective performance at different levels of the organization

**Step 1. Increase accounting and reporting transparency to facilitate more mature profitability assessment capabilities**

**Appropriate bookkeeping systems.** For CFOs, the fundamental step is to ensure that appropriate bookkeeping systems are in place in order to track basic results of operational performance and highlight major operational inefficiencies.

One important milestone is to ensure that reliable corporation-wide information systems are implemented to perform in-depth analysis at each level of the firm. Corporations may also rely on data mining, big data and powerful statistical tools to provide a better understanding of their businesses to uncover unknown relationships between the different layers affecting the overall profitability.

**Accurate revenue tracking.** In the first stages of this framework, corporations shall reinforce their ability to measure and forecast revenue generated at the most granular levels. It is fundamental for CFOs to understand their sales at the consolidated level for:

- Products and the portfolio of products
- Clients while taking into account all the affiliates on a regional and global scale when relevant. For global businesses, for example, estimating sales for products available worldwide or for large and diversified clients is often challenging: this requires efficient harmonized consolidation tools and extensive analyses

**In-depth understanding of costs.** In subsequent stages of maturity reporting, corporations will acquire a stronger vision of the nature of their costs while increasing their ability to allocate costs by products and clients. Corporations need to capture the fundamental nature of their costs by breaking them down into several categories. These different categories could be:

- Direct costs, which are often called “true costs” of products and services. These costs are usually better understood and easier to allocate to specific product lines. An important challenge associated with some direct costs which are variable, is their volatile aspect. Indeed, in a wide range of industries, profitability relies heavily on the ability of companies to anticipate future levels of costs (i.e., raw materials costs, oil prices, etc.). For this reason, corporations should build reactive monitoring systems in order to adapt their pricing strategies with their current sourcing costs in real time
- Indirect costs need a close attention as well, especially since these costs are usually harder to grasp. Corporations must build a comprehensive view of all their cost and profit centers and understand the major drivers behind them. In large and global companies, indirect costs represent a significant part of the overall cost structure and therefore it is important to accurately capture them so as to get a complete picture of the whole profitability and not a marginal profitability view based solely on direct costs

“Activity-Based Costing” (ABC) is found to be a relevant method for CFOs to identify the main cost drivers for all the different activities, products and services provided. ABC actually aims at allocating all the costs (direct and indirect) associated with each product or service produced based on the real consumption of all the different types of inputs used in the value creation process. Total costs are then derived by multiplying the total cost per product with the total volume for each product.

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An efficient governance system should also be in place to empower leaders and gather the people that will ensure that targeted goals are met

One major drawback of ABC is that firms have to develop complex models which may not be relevant for industries where products or services delivered to clients are highly customized or tailor-made. In such cases, cost drivers are hard to identify and ABC models become too complex and difficult to build and maintain. By using simplified models such as the 80-20 view, which allows a 20 percent margin error on profitability assessments, CFOs may build efficient ABC models while saving time and resources.

This approach must be used carefully, however: inappropriate, indirect costing systems may lead to under or overestimated costs associated with specific products or clients. Therefore, consistently updating and restating allocation keys properly is crucial in developing and maintaining strong reporting and planning systems.

Test and trials approaches along with benchmarking exercises could also be used to further improve analyses. CFOs should keep in mind that incorrect cost allocations may favor some competitors playing with better allocation rules, enabling them to boost their market shares.

In addition, ongoing assessments and evaluations should also be conducted - what was obvious in the past may no longer be relevant today.





## Step 2. Go from cost analysis to cross-dimensional profitability measurement

### Three-dimension vision of the firm's profitability.

Given the dynamic aspect of the market, CFOs should challenge their traditional cost and revenue approach with more specific metrics aligned with current focuses and evolutions of their firms. Indeed, CFOs should develop a more holistic approach and challenge their traditional standard corporate profitability measurement as highlighted in the graph below:

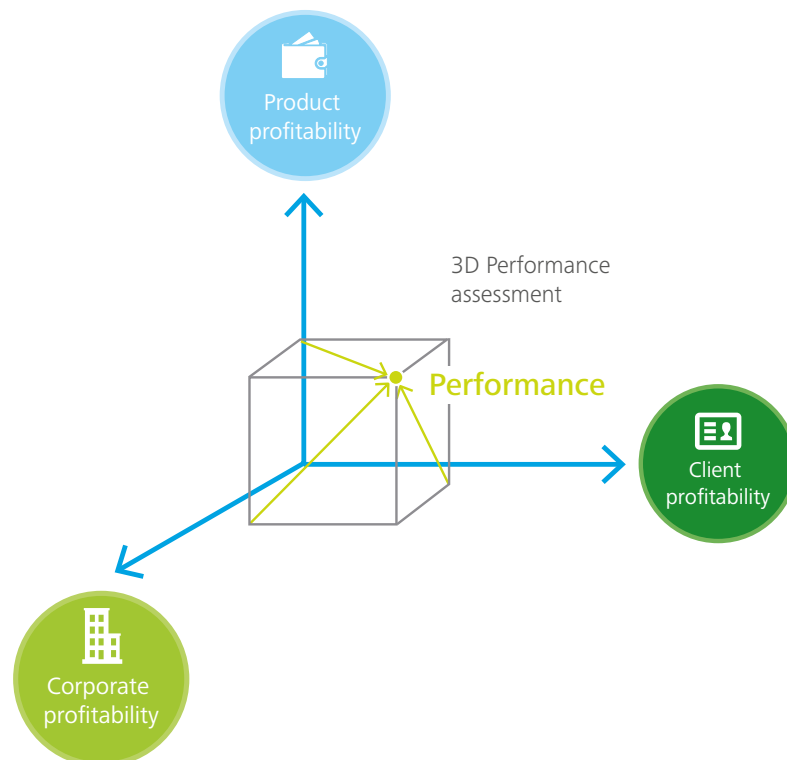
In this approach, one should determine that the overall cost structure is adequately sized with current levels of revenues generated while at the same time ensuring that each product is properly priced for each customer and that each client's overall profitability is appropriately distributed.

**Corporate profitability analysis.** For every corporation, it is crucially important to have an overall consolidated view of all the sources of income and costs in order to take effective action against major inefficiencies easy to capture at the consolidated level. This method helps the CFO to analyze all the different costs by their nature and compare them with underlying activity and profitability figures. This could also allow firms to better benchmark themselves with their competitors.

From this approach, corporations may for example outline that abnormally high tax charges are currently paid and might seek new ways to optimize their tax expenses.

In-depth analysis of financial or legal provisions at the consolidated level may also uncover issues or concerns about internal auditing systems, which can be further structured in order to optimize the long-term profitability of the firm by reducing levels of risks and of future provisions.

Figure: The three dimensions of firm profitability



On the other hand, insufficient investment costs may, for example, outline a slow deterioration of the firm's long-term competitiveness on its market (i.e., low R&D or preventive maintenance levels).

A strong understanding of current and full capacity levels is also key: in most fixed cost intensive businesses with under-usage of their current capacity, gaining new clients will most likely increase profitability associated with actual clients, while improving the profitability of the whole firm. In the retail-banking industry for example, strategies focusing on boosting sales in branches where the capacity utilization is lower may increase the overall revenue quickly while maintaining the current level of costs.

Overall, marginal and incremental profitability analyses should be conducted alongside traditional full profitability analyses in order to identify potential opportunities to enhance total profitability by increasing revenues, allocating fixed costs in a more efficient way, and performing economies of scale.

**Product profitability assessment.** At the level of each business unit, it is key to understand product cost structures in order to ensure that CFOs have an accurate view of their profitability levels in a dynamic environment at each stage of product life cycles.

Indeed, finance leaders should be involved from the product design phase in order to help designers to correctly assess the different costs associated with new products. Ongoing measurement of product profitability in latter stages shall also be conducted in order to ensure that the initial profit target is met.

Identifying each product's cost structure will also lead to better pricing and reinforce the firm's ability to better align its revenues with its cost drivers. As a matter of example, in the asset servicing industry, administrators used to apply fees according to the fund's assets, regardless of the size of the fund.

This method was not taking into account the fixed costs incurred during the day-to-day activity (Fund Net Asset value calculation, etc.). However, the Madoff crisis in 2008 led to a significant drop in the amount of assets managed, and the revenues produced were not sufficient to cover actual fixed costs. Subsequently, administrators added fixed fees in order to cover the fixed costs and to minimize the effects of the crisis.




**Client profitability measurement.** Still at the level of the business unit, once finance teams determined sales at granular levels and profitability at the product level, profitability at the client level can easily be determined with simple financial models:

- Revenues are identified through invoices paid
- Costs can be simulated using a client's total sales volume for each product and total cost per product (as explained in the previous section)

This approach will enable the management team to determine which customer segment is driving the business unit profitability and will help solve simple questions such as: is the profitability of clients from a specific sector outperforming the average profitability of other clients? Are margins evenly distributed among the different customers? Are margins greater on smaller or larger customers? What is the impact of commercial gestures on the client profitability? Does the pricing applied to the client effectively cover the operated activities (in some cases, clients have been asking for additional services which did not lead to price adjustments)?

Client profitability measurement exercises should also be conducted at the consolidated level in order to quantify the total exposure of the corporation to any specific client. The combined use of business unit and consolidated client profitability measurements should help to better tailor client-specific marketing strategies at the corporate level and maximize total profitability at the client level while minimizing risks of losing important customers.

The following table provides examples on possible axes for reflection and action on costs and revenue parts of the analysis:

	Revenue improvement initiatives	Cost reduction initiatives
 Corporate level	<ul style="list-style-type: none"> <li>• Determine if the corporation can onboard new clients without increasing its fixed costs or recruit new staff (i.e., are economies of scales possible?)</li> <li>• Assess the effects of taxation on the overall profit</li> </ul>	<ul style="list-style-type: none"> <li>• Assess whether indirect costs associated with specific activities can be outsourced in order to improve overall profitability</li> <li>• Centralize administrative and support functions in order to enhance operational efficiency and reduce specific types of costs</li> </ul>
 Product level	<ul style="list-style-type: none"> <li>• Revisit the pricing on specific product lines, if this one does not cover the costs</li> <li>• Develop marketing campaigns/distribution channels to boost sales of products if volumes do not meet target levels</li> </ul>	<ul style="list-style-type: none"> <li>• Automate processes</li> <li>• Reduce the range of products offered by discontinuing non-profitable products or segments</li> </ul>
 Client level	<ul style="list-style-type: none"> <li>• Renegotiate contracts or fee schedules with low-margin customers</li> <li>• Accept commercial gesture requested by clients</li> <li>• Refocus activity on the most profitable clients</li> <li>• Increase cross-selling and upselling initiatives to counterbalance low-margin products</li> <li>• Accompany high-margin clients on new markets</li> </ul>	<ul style="list-style-type: none"> <li>• Propose clients to standardize some products which require specific processes, generating an extra layer of costs</li> <li>• Review the service offering by reducing costs and increasing the client focus</li> </ul>

The implementation of such approaches has allowed many fast growing companies to structure their financial planning and reporting functions in order to better structure their corporations and to keep their costs under control. This also improved their future perspectives by developing more targeted revenue analyses at the client and product level and helped them to shape and structure their strategy. This point is key for maturing companies in order to adapt themselves and better manage their costs and resources to overcome their transition phase and support future growth.

### Step 3. Taking action: build an action plan and create an appropriate governance framework to optimize business performance

Once clear ways of profit improvement are identified, corporations must determine key initiatives to implement with a realistic plan that will get results quickly while improving long-term efficiency. As soon as new strategic guidance is established, corporations will need to ensure that projects are monitored properly and that appropriate resources are deployed in order to meet new targets.

#### 10 Key Success Factors for CFOs to succeed in a competitive business world





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