Capturing value in a shifting environment

Path to value for wealth management centers

Dr. Daniel Kobler
Partner
Head of Banking Strategy
Consulting Services
Deloitte

Jürg Frick
Partner
& Vice Chairman
Head of Banking Practice
Deloitte

Felix Hauber
Senior Manager
Banking Strategy
Consulting
Deloitte

Dr. Stefan Bucherer
Manager
Banking Strategy
Consulting
Deloitte

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

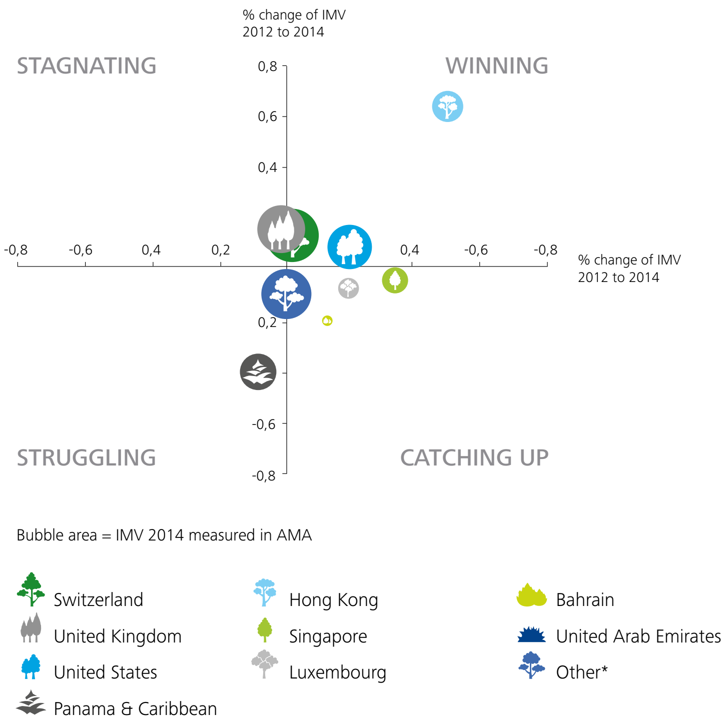
and 2012. Therefore, both centers are positioned on the borderline between the winning and stagnating quadrants. Panama & the Caribbean lost a substantial amount of market share to the United States. Other European centers, excluding Luxembourg, did not quite manage to catch up although they avoided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

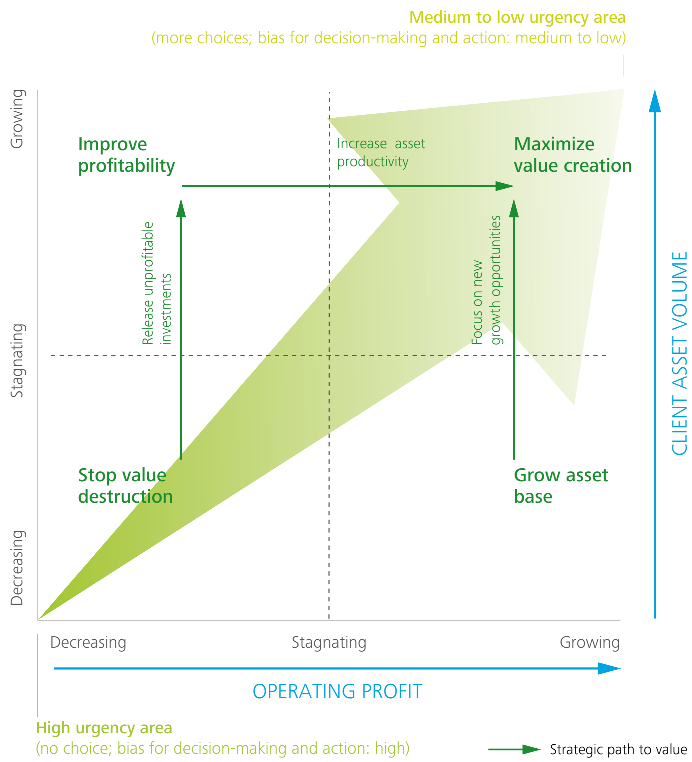
We observe a global trend of assets repatriation. The result of the international pressure to lift banking secrecy is the loss of privacy, which particularly impacted Switzerland, Liechtenstein and Luxembourg. The retrospective reinterpretation of applicable law lowered the trust of clients in stable 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

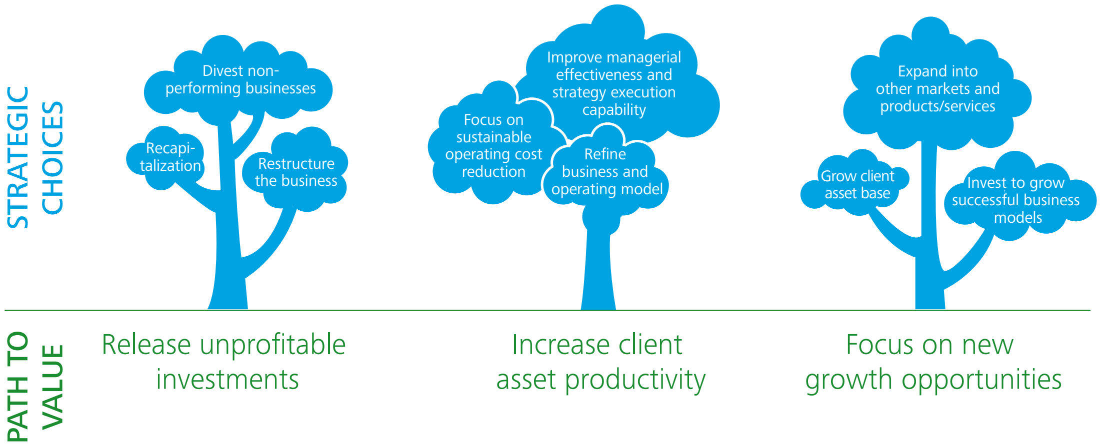
International market players face the challenge of restoring strong growth in their business as well as increasing their profitability, by improving their operational performance and attracting new client assets. In order to find their path to value, some strategic changes may be necessary. However, 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.