



From private banking to wealth management Challenges and opportunities

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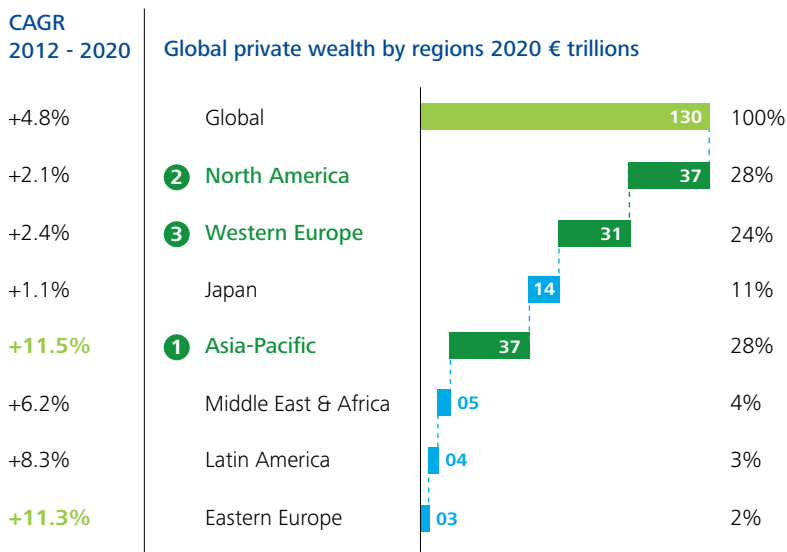
The recent financial crisis has led to a global movement in the U.S., Europe and elsewhere towards new and enhanced regulations as well as increased tax transparency pressure aimed at protecting both the banking system and clients. The impacts of this global movement are being felt across the entire banking industry.

These changes are pushing all those in the industry to adapt their business model in order to survive in an ever changing environment. In particular, private banks must rethink their vision as well as their business model, service offering, client segmentation and operational model while coping with constant profitability pressures.

Changes in the wealth management landscape¹
Europe and the U.S. will remain the largest financial centres in 2020

In 2012, global financial wealth grew by 8.2% to reach a total of €102.9 trillion.

North America, Western Europe and Japan remain the three main profit pools for private banking, though emerging countries such as those in the Asia-Pacific region are gaining ground over developed countries and this trend is expected to continue in the coming years.



The light green CAGR figures represent the two highest expected growth rates.

¹ Dark blue CAGR figures represent the two highest expected growth rates

According to the latest economic forecasts, the Asia-Pacific region will account for over 80% of global growth through 2020 (with growth mainly deriving from the creation of new wealth). China, India and Russia are projected to become the largest generators of wealth in the Asia-Pacific region, while the U.S. will remain the largest wealth market globally.

Western Europe will remain a key location for the geographical footprint in wealth management

Within the global wealth management landscape, Europe is performing well with an increase of 10% in Assets under Management (AuM) in 2012 and is reporting relatively good results when compared to other regions of the world. In terms of revenues, Europe is still a more lucrative market in general with more than 76 bps or gross revenues on assets as compared to 70 bps in emerging countries which are much more competitive and price sensitive. It is also a more efficient market with an average cost-income ratio of 65% compared to 80% in the U.S.

Targeting emerging countries such as those in the Asia Pacific region is not a must but a reality

The regional increase in AuM in 2012 was mainly driven by strong market performance combined with an increase in net new assets.

Once more, emerging regions such as Asia-Pacific or Latin America score well in both categories (performance and new assets). This trend emphasises the potential advantages for private wealth institutions to build presence in these regions and the need for European players to make a choice concerning what strategy should be adopted in order to acquire new assets:

- Either they should focus on **maximising 'performance of existing wealth'** in developed countries by optimising their value proposition to gain market shares and/or by focusing on cost efficiency
- And/or they should focus on the **'new wealth creation'** in emerging countries by taking a market share of the wealth growth in these regions

The main focus of wealth management institutions is currently Asia, and even European institutions, which are busy maximising the performance of existing wealth, complement their core strategy with a 'deployment strategy' in emerging countries to ensure the continuity of their business. Nevertheless, this re-orientation is a complex challenge and a long-term commitment for wealth managers who will have to adapt their service offering to meet local needs if they want to gain market shares in the region.

The HNW² and UHNW³ client segments are set to grow in the coming years and remain the most attractive segment in the long run

Globally, the number of millionaire households (HNWI) grew by 10% to reach about 13.8 million in 2012. Although, the number of HNWIs decreased slightly in the United States and Japan, the positive global growth has been supported by the increasing numbers of HNWIs in emerging countries (15% increase in 2012), especially in China where many households crossed the millionaire threshold to reach 1.3 million in 2012.

However, in order to rapidly gain market shares and capture additional margins, wealth managers can also consider targeting the mass affluent client segment by proposing a diversified yet standardised and industrialised service offering

² HNW: High Net Worth – individuals with over €1 million in assets

³ UHNW: Ultra High Net Worth – individuals with over €10 million in assets

North America still has the largest number of millionaire households (5.8 million), followed by Japan (1.5 thousand) and China (1.3 thousand) which should continue to grow in the coming years supporting the major shift in the country breakdown of HNWI's.

The same trend can be seen in the number of Ultra High Net Worth Individuals (UHNWI) which increased by 7% in 2012, with North America still having the largest number (3 million). When looking at the share of wealth by household segment, UHNW households will experience the strongest growth (more than 8%) in the coming years, especially in emerging countries. Ultra high net worth households should have €12.5 trillion by 2020.

It is interesting to note that different business models targeting the same or different client segments co-exist: typically, wealth management players (be they banks or wealth managers) are serving UHNW clients while universal banks are also targeting the HNW segment.

However, in order to rapidly gain market shares and capture additional margins, wealth managers can also consider targeting the mass affluent client segment by proposing a diversified yet standardised and industrialised service offering.

This strategic choice can only be a short-term decision since targeting mass affluent clients will lead to relatively slow growth in AuM. On the other hand, focusing on the UHNW and HNW segments represents a long-term choice for private banking players who will need to adapt their services to satisfy their HNW and UHNW clients in a very competitive and changing market: more value for money, looking at the overall service versus focusing on performance, increased technical awareness and expectations, etc.

Luxembourg as a competitive marketplace

Luxembourg is a European cross-border hub for wealth management

The European reach of the Luxembourg wealth management industry combined with the European passport allows institutions to serve clients in the entire European Union out of Luxembourg. The status of Luxembourg as a European cross-border hub is one of its major advantages and a key location factor in the global wealth management landscape. Luxembourg continues to position itself as a global specialist in the financial industry.

Luxembourg benefits from many macroeconomic advantages compared to other European countries as well as a favourable tax and regulatory environment allowing the creation of a sophisticated onshore service value proposition.

Key location factors of Luxembourg

- Strong expertise in wealth management and availability of experienced workforce
- Stable and sound economic (AAA rating for the country), political, social and fiscal environment, especially compared to other European countries
- Dynamic economic environment
- Low debt
- Low inflation rate
- Reactivity and proactive involvement of the government in the strategic development of the country's main financial industries
- Strong investor/data confidentiality and protection policy while fully respecting international tax information exchange requirements (i.e. focus on data discretion and protection and not on data secrecy)
- Multi-cultural, polyglot and skilled labour force
- Low unemployment rate

Typical clients in Luxembourg

Luxembourg, like all other major financial centres, is subject to global challenges and pressures on revenues, and mainly attracts clients and assets from neighbouring European countries.

The typical private banking client in Luxembourg is a continental European who earned his wealth through entrepreneurship or inheritance and requires advisory services (80% of mandates). Clients in Luxembourg originate from the entire European Union with the majority coming from neighbouring countries like Belgium, France and Germany.

In recent years a shift from mainly mass affluent clients to HNWIs and UHNWIs has been observed, leading to a consolidation of the client base (in terms of the number of clients, not in terms of assets).

Players

Private banking in Luxembourg, representing around 6% of the international private banking market, is currently composed mostly of **three types of institutions**:

1. Private banks representing over three quarters of the private wealth market in Luxembourg
2. Wealth management companies representing just under a quarter of the market share
3. Family offices entering the market with a current market share of around 5%

The emergence of some new categories of business, such as family offices, is driving Luxembourg to adapt its wealth management services in response to new client segments and operating models.

While AuM are expected to grow, profitability remains under pressure

A combination of poor market performance, shifting client preferences and increasing regulatory requirements is keeping the industry's cost base under pressure. Wealth management institutions have to deal with several challenges impacting both their cost and revenue baselines:

Pressure on cost baseline

The pressure to remain competitive is higher for existing players as they have to rethink their current business and operating models in light of multiple market evolutions and macro trends. The costs of transforming legacy activities and platforms and of managing the changes within the organisation are generally extremely high. Here are some examples of challenges impacting the cost baselines of wealth management institutions:

The regulatory pressure is accelerating with global and local initiatives seeking transparency, customer protection, prevention of financial crime, market stability and tax compliance. To face this ever changing regulatory landscape, wealth management operators are spending more on projects to ensure compliance with the new requirements by the deadlines imposed, to develop the right competencies to face these challenges and to adapt or launch new compliant products and services.

IT costs are also increasing. Having a modern, state-of-the-art and agile IT platform is now a must, especially owing to competition and the need for data management, distribution models (e-private banking, mobile banking) and new services (tax reporting, tax reclaims, etc.) required by the new regulations as well as by clients themselves. Players have to challenge their existing IT architecture to align it with their operational model which is evolving towards more hub-and-spoke activities, centres of excellence and the offshoring of some operations, etc., while keeping the related costs (total cost of ownership of the IT systems) as low as possible.

Wealth management institutions have to deal with several challenges impacting both their cost and revenue baselines

New client targets are appearing and becoming increasingly important (clients from new markets, especially from emerging countries; the new generation of HNWI and UHNWI). To attract these new clients and meet their needs, proximity and local knowledge are required, which means higher operating costs than for 'historical' local or regional private banking clients.

The 'traditional' approach linking wealth band segments and service offering is evolving towards a more granular segmentation, pricing strategy and packaging. New value-added services are now expected by certain categories of clients, such as tax reporting, tax relief and tax reclaims, online and consolidated reporting, asset structuring, reporting performance and performance attribution or even the opportunity to invest in collectible asset classes (e.g. wine, art).

New private banking clients are more knowledgeable and have higher expectations. Wealth managers will have to adapt their business models to serve this category of clients. As a result, they will mainly have to invest in training programmes and hire new talent able to connect with and understand this new generation, and able to better profile them. Upskilling and training private bankers as well as developing a network of experts are prerequisites to meeting the expectations of the new client segments. For example, relationship managers will have to develop the right skills and competencies to provide wealth structuring advice, present new products and services and act as the central access point to an internal and external network of expertise.



Pressure on revenue baseline

The banking industry and its clients are seeking transparency with tax information exchange agreements between countries, tax amnesty for repatriation and double taxation treaties. These new market trends have numerous consequences and are calling into question the competitive advantages of some pure offshore and non-transparent tax private banks compared to local banking partners in home countries.

Furthermore, clients are increasingly 'self-guided', risk averse and price sensitive. By having access to multiple sources of information (internet, social media, e-private banking, mobile banking and their relationships managers) and benefiting from the advantages of transparency requirements aimed at protecting them, clients can

benchmark the offerings between players in terms of breadth, depth and quality of services as well as pricing. As a result, clients can also exert **pressure on banks' pricing structures**.

Private banks in western Europe have been constantly reducing their average fees in the last few years. Historically, wealth managers and private banks could generate north of 100 bps of assets under management. Today, overall fees amount to an average of 75 bps and are expected to decrease steadily to reach about 50 bps. Although the fee level does vary significantly depending on the risk profile and asset classes used by clients, the downward pressure and the extent of this pressure is a good indication of how much banks and wealth managers are suffering from revenue decreases.



In this context, private banks have launched strategic initiatives to protect or increase revenues as well as transformation programmes to streamline their cost base. Private banks that aspire to become or remain leaders are adapting their offering and delivery models and carefully choosing both the markets and customer segments they wish to serve. Most of our clients, in all tiers of the private banking and wealth management industry, have launched strategic initiatives aimed at:

- Defining a target-appropriate geographical footprint (geographical footprint optimisation)
- Defining proper product and service range and coverage
- Defining appropriate and best communication channels
- Defining new pricing models
- Upgrading staff skillsets

In parallel to these strategic growth and top-line initiatives, private banks have transformed and optimised their current operating and technical model so as to equip

themselves with an agile, flexible and cost-efficient model. But there is still a long way to go to achieve full efficiency or target cost levels and we are observing new models being contemplated such as the outsourcing or pooling of some operations, something that, in private banking, was still taboo not so long ago.

In this context, market players are focusing on transformation programmes aimed at:

- Addressing compliance requirements in an efficient manner
- Aligning IT and operational models
- Outsourcing costs (BPO/ITO, etc.)
- Performing efficiency and 'lean' reviews
- Considering an exit strategy and identifying the most likely category of buyers

