

Global Market Overview

In the late 1990s, wealth management was reported to be the fastest growing sector of the financial services industry. Though the 2000–2002 downturn took its toll on many wealth management providers, looking ahead, the industry remains attractive, with strong fundamentals. Globally, the number of millionaires continues to grow at more than 7% a year – around 6 times the pace of the population as a whole.¹ The industry is certainly up there with investment banking in terms of fun, glamour and glitz. However, to meet the evolving needs of clients, the industry has become increasingly broad and complex.

For decades, the industry was dominated by a select group of sleepy, very traditional players. But during the 1990s, the industry changed almost beyond recognition. There was a huge influx of new players offering a wide range of specialised products and services to a broader, ever more demanding client base.

The aims of this introductory chapter are to:

- Define the wealth management market and provide an idea of its size and recent growth.
- Examine the key drivers of the wealth management industry.
- Outline the economics of the industry.
- Briefly describe the competitive landscape.

Most of the themes introduced here will be explored in more detail in later chapters.

1.1 THE WEALTH MANAGEMENT MARKET

There is no generally accepted standard definition of wealth management – both in terms of the products and services provided and the constitution of the client base served – but a basic definition would be financial services provided to wealthy clients, mainly individuals and their families.

Private banking forms an important, more exclusive, subset of wealth management. At least until recently, it largely consisted of banking services (deposit taking and payments), discretionary asset management, brokerage, limited tax advisory services and some basic concierge-type services, offered by a single designated relationship manager. On the whole, many clients trusted their private banking relationship manager to ‘get on with it’, and took a largely passive approach to financial decision making.

Private banking has a very long pedigree, stretching back at least as far as the seventeenth century in the case of some British private banks.² It is, however, only really over the last 15 years or so that the term ‘wealth management’ has found its way into common industry parlance. It developed in response to the arrival of mass affluence during the latter part of

¹ The compound annual growth rate (CAGR) in the global number of millionaires, 2002–2004, is 7.4% (*source*: Capgemini/Merrill Lynch). The CAGR in the global population, 2000–2005, is 1.2% (*source*: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, 2004).

² See Maude and Molyneux (1996), Chapter 1, for a discussion of private banking origins and historical evolution.

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the twentieth century; more sophisticated client needs throughout the wealth spectrum; a desire among some clients to be more actively involved in the management of their money; a willingness on the part of some types of financial services players, such as retail banks and brokerages, to extend their offerings to meet the new demand; and, more generally, a recognition among providers that, for many clients, conventional mass-market retail financial services are inadequate. Wealth management is therefore a broader area of financial services than private banking in two main ways:

- *Product range.* As in private banking, asset management services are at the heart of the wealth management industry. But wealth management is more than asset management. It focuses on both sides of the client's balance sheet. Wealth management has a greater emphasis on financial advice and is concerned with gathering, maintaining, preserving, enhancing and transferring wealth. It includes the following types of products and services:
 - (a) Brokerage.
 - (b) Core banking-type products, such as current accounts, time deposits and liquidity management.
 - (c) Lending products, such as margin lending, credit cards, mortgages and private jet finance.
 - (d) Insurance and protection products, such as property and health insurance, life assurance and pensions.
 - (e) Asset management in its broadest sense: discretionary and advisory, financial and non-financial assets (such as real estate, commodities, wine and art), conventional, structured and alternative investments.
 - (f) Advice in all shapes and forms: asset allocation, wealth structuring, tax and trusts, various types of planning (financial, inheritance, pensions, philanthropic), family-dispute arbitration – even psychotherapy to children suffering from 'affluenza'.
 - (g) A wide range of concierge-type services, including yacht broking, art storage, real estate location, and hotel, restaurant and theatre booking.

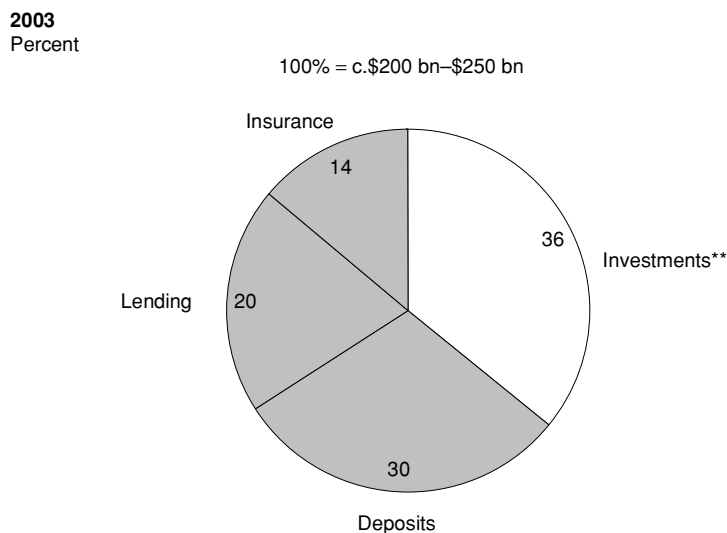
Based on research by BCG, non-cash investments may account for no more than c.36% of the global wealth management revenue pool (see Figure 1.1).

- *Client segments.* Private banking targets only the very wealthiest clients or high net worth individuals (HNWIs): broadly speaking, those with more than around \$1 million in investable assets. Wealth management, by contrast, targets clients with assets as low as \$100 000, i.e. affluent as well as high net worth (HNW) clients.

Robert J. McCann, President of the Private Client Group at Merrill Lynch, provided a succinct definition of wealth management at a recent industry conference:

[Wealth management] addresses every aspect of a client's financial life in a consultative and a highly individualised way. It uses a complete range of products, services and strategies. A wealth manager has to gather information both financial and personal to create an individualised series of recommendations, and be able to make those recommendations completely tailored to each client. Off the shelf – it won't do. What [wealth management] requires is connecting with clients on a personal level that is way beyond the [retail financial services] industry norm.

When asked to describe the factors that distinguish their services from other types of retail financial institution, wealth managers emphasise the uniqueness of their client relationships – relationships that are *broad*, in that they encompass all areas of a client's financial life, and *deep*



*From households with AuM > \$100,000

**Including managed funds and directly held securities

Figure 1.1 Wealth management revenue pool* by product

Source: Boston Consulting Group; author's calculations.

with respect to the advisor's intimate knowledge of a client's values and priorities. In turn, this breadth and depth of relationship enables the wealth manager to develop and implement highly tailored solutions that address all aspects of a client's financial well-being. At a minimum, the following three criteria differentiate a firm as a wealth manager:

- The *relationship* that wealth managers have with their clients, both in terms of breadth (where providers emphasise terms such as 'holistic', 'comprehensive' and 'all-inclusive') and depth ('intimate' and 'individualised').
- The *products and services* provided, with a particular emphasis on estate planning and multi-generational planning services, as well as tax advisory expertise and alternative investments.
- The *specific objectives of wealthy clients*, such as investment performance, wealth preservation or wealth transfer.

1.1.1 Investment mandates

Wealth managers may serve clients under different types of investment mandate. At the most basic level, the wealth manager may act as a pure *custodian* for a client's assets. That involves, essentially, asset safekeeping, income collection, fund disbursement and associated reporting.

Under an *execution-only mandate*, the wealth manager executes, or selects brokers to execute, securities transactions on behalf of the client. The wealth manager does not provide investment advice, so this service is aimed primarily at self-directed clients. The wealth manager

is typically required to seek ‘best execution’ for client transactions, i.e. executing transactions so that the client’s total cost, or proceeds, in each transaction is as favourable as possible to the client under the particular circumstances at that time.

The next level of investment mandate is a formal service-level contract, of which there are two types:

- *Advisory mandate*, under which the wealth manager will discuss and advise the client on investment opportunities. The client then makes the buying and selling decisions based on a combination of his or her own ideas and the investment advice of the wealth manager. The wealth manager will not make any investment decision without the client’s prior approval. The wealth manager is generally paid a commission based on the volume of executed trades, plus custody fees.
- *Discretionary mandate*, under which the wealth manager usually has sole authority to buy and sell assets and execute transactions for the benefit of the client, in addition to providing investment advice. Discretionary management works by starting off with the construction of a brief with the client, detailing investment aims, level of risk-aversion and other factors that will influence the portfolio. In some discretionary accounts, the wealth manager is given only limited investment authority. However, in all cases, major investment decisions, such as changing the account’s investment strategy or asset allocation guidelines, may be subject to the client’s approval. The wealth manager is generally paid on the basis of a flat-fee arrangement linked to the value of the assets under management. The gross revenue margin of a discretionary mandate is typically at least double that of an execution-only mandate.

The proportion of clients using advisory mandates is, in general, relatively stable across the various client wealth bands. Execution-only mandates become more prevalent, and discretionary mandates less prevalent, as client wealth rises. That typically reflects a greater degree of financial sophistication among the wealthier clients.

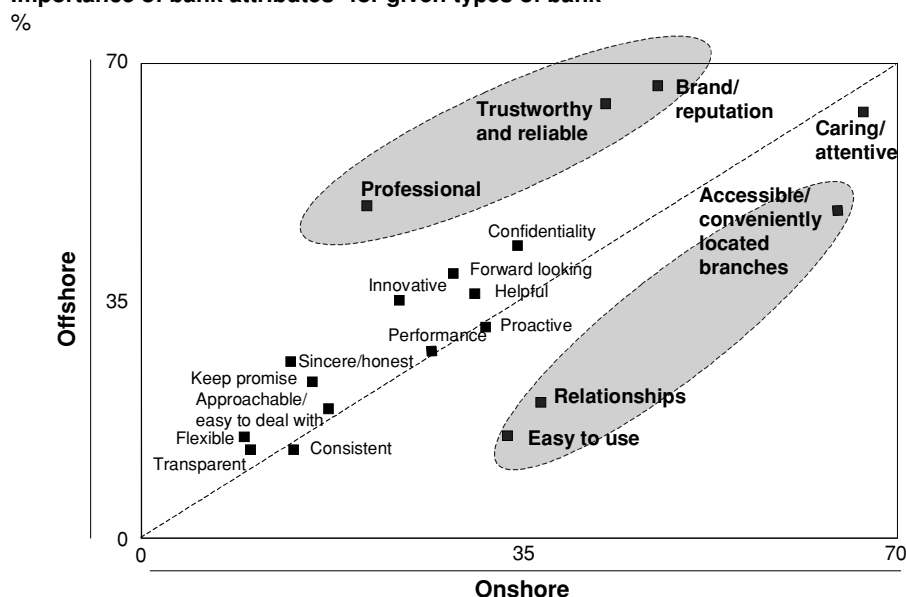
Wealth management can mean different things in different geographic regions. The US and Europe have traditionally stood at two extremes in this regard. In the US, wealth management is more closely allied to transaction-driven brokerage and is typically investment-product driven. In Europe, the term is more synonymous with traditional private banking, with its greater emphasis on advice and exclusivity.

1.1.2 Offshore versus onshore

A fundamental distinction within wealth management is onshore versus offshore. Onshore wealth management is the provision of products and services within the client’s main country of residence. Offshore wealth management, by contrast, serves clients wishing to manage their wealth outside their main country of residence for reasons such as: financial confidentiality; legal-system flexibility; tax considerations; the lack of appropriate products and services onshore; a low level of trust in domestic financial markets and governments; and the need for safety and geographical diversification in response to domestic political and macroeconomic risks. Indeed, some clients treat their offshore account(s) primarily as a ‘vault’.

Some practitioners go further and refer to four types of wealth management. Take the example of a Swiss wealth manager. It will, of course, have a presence in Switzerland: its domestic business. Its domestic business will typically serve two types of clients. First, there are Swiss clients seeking to keep assets within their own country of residence, which is referred to as the

Importance of bank attributes* for given types of bank



*Multiple answers possible

Figure 1.2 Wealth manager attributes

Source: McKinsey & Company, 'Annual Investment and Wealth Management CEO Conference, 2005'. Reproduced by permission.

wealth manager's domestic onshore business. Its domestic business may also serve clients from outside Switzerland, which is referred to as the wealth manager's domestic offshore business. The Swiss wealth manager may also have a presence outside Switzerland: its international business. That may include a presence in Italy, serving both Italian clients (i.e. its international onshore business) and non-Italian clients (i.e. its international offshore business).

The onshore/offshore distinction matters because these two types of wealth management have very different client appeal, dynamics, product sets and economics (see below). Figure 1.2 illustrates that offshore private banks need, in particular, strong brands, trustworthiness and a high degree of professionalism. For onshore private banks, there is greater emphasis on local branch presence, strong relationships and 'user friendliness'.

As Figure 1.3 illustrates, the proportion of wealth managed offshore varies significantly across regions. There is a general trend for assets to shift onshore, particularly in Western Europe, which is primarily driven by a series of global tax initiatives (see Chapter 9). But that shift is happening at different speeds, and some regions – including Africa, the Middle East, Latin America and Eastern Europe – continue to have a sizeable offshore wealth component. At the client level, the proportion of wealth held offshore tends to rise in line with the level of wealth. In terms of offshore wealth destinations, the main offshore centres are Switzerland, the United Kingdom (including the UK Channel Islands – Jersey, Guernsey and Isle of Man), Hong Kong, Singapore, Luxembourg, Gibraltar, Monaco, Cayman Islands, the Bahamas, New York

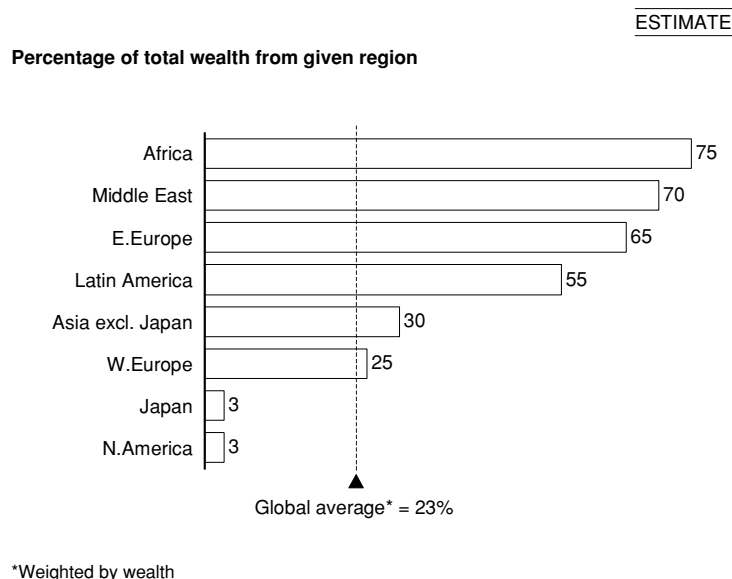


Figure 1.3 Wealth held offshore
Source: Boston Consulting Group; Julius Baer; author's client work.

and Miami. There are different types of offshore centres. Some – such as London, New York and Miami – offer a comprehensive range of private banking services in their own right. Others, such as the Cayman Islands, are principally booking centres, where funds and transactions are registered.

1.1.3 Market size and growth

Primary questions for wealth managers the world over is: who are the wealthy and how much wealth do they have?

Measuring the size of the wealth management market is certainly no easy task. For a start, as noted above, there is no generally accepted market definition. Individual institutions differ widely both in the level of the wealth threshold they use to separate a wealth management 'client' from a mass-market 'customer', and in how they define wealth itself. Frequently used metrics include: annual gross income, liquid financial assets, investable assets, net worth (i.e. assets net of debt) or some combination of these. The thresholds are sometimes defined by the geographic market that the wealth management provider is targeting.

The wealth management market is probably best thought of as a group of distinct submarkets, based on client wealth bands. Again, institutions vary considerably in how they define these wealth bands and in how they label them (see Figure 1.4). Broadly, the market can be divided into two subgroups – affluent and high net worth – with, in turn, further subsegmentation within each.³

³ Note that the focus here is on defining the overall market. Chapter 3 provides a more detailed discussion of client segmentation practices at the more granular level.

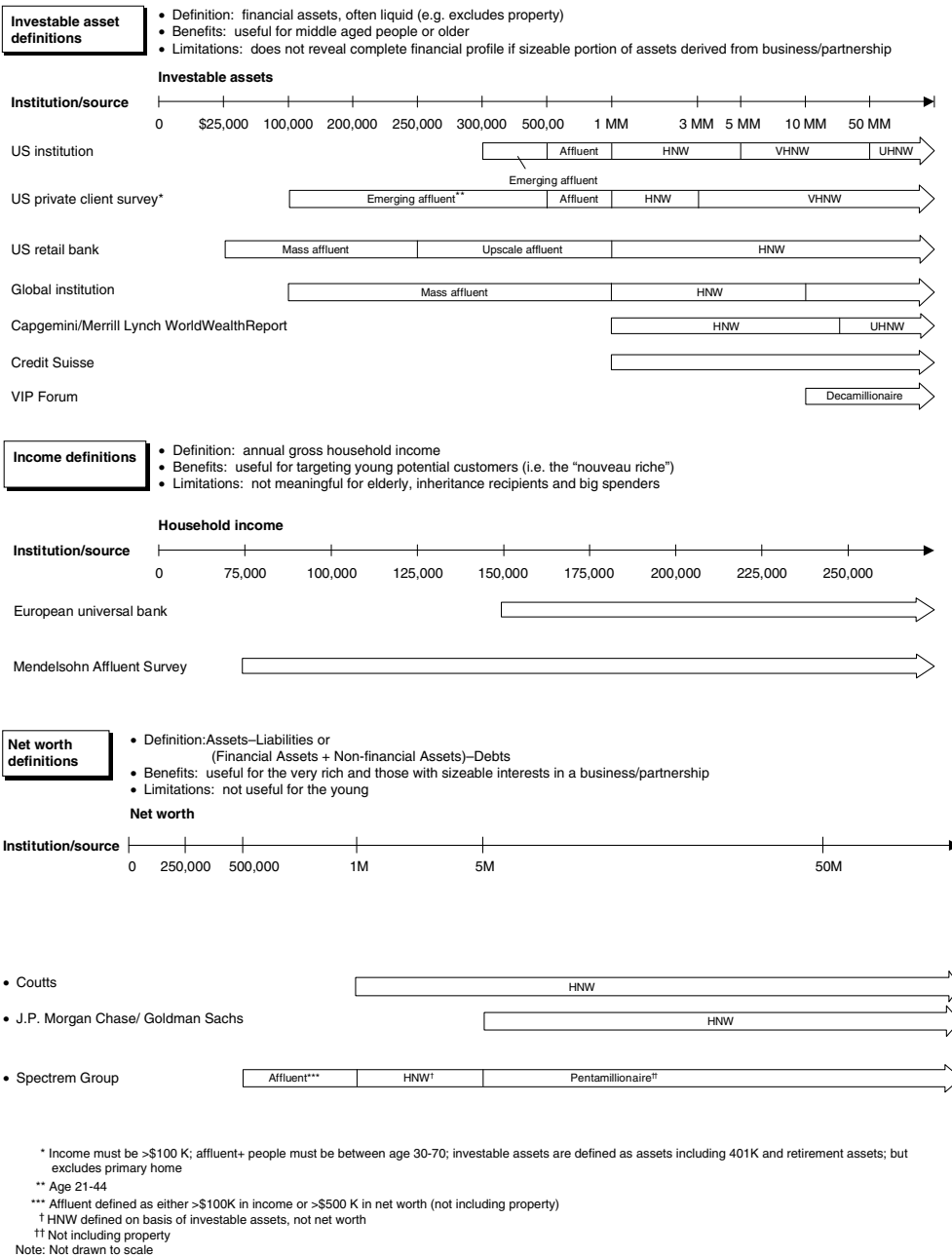


Figure 1.4 What is wealthy? Client indicative wealth threshold definitions

Source: Author's analysis.

EXAMPLES OF DIFFERENT ENTRY CRITERIA APPLIED BY PRIVATE BANKS

Example 1	<ul style="list-style-type: none"> • Minimum account size USD 1m
Example 2	<ul style="list-style-type: none"> • USD 5m+ of bankable assets
Example 3	<ul style="list-style-type: none"> • Minimum account size USD 0.5m or • Use of derivative products or • Use of discretionary mandate or • Language requirements
Example 4	<ul style="list-style-type: none"> • Decision of relationship manager based on assessment of client's financial potential
Example 5	<ul style="list-style-type: none"> • Minimum USD 0.2m with minimum advisory management services • Minimum USD 0.5m in discretionary management with limits on investment possibilities • Minimum USD 1m in discretionary management without limits

Figure 1.4 (Continued)

There is no industry-wide minimum requirement for the bankable assets entry criterion. In any case, the minimum account size often reflects the bank's aspiration rather than reality (even at the most upscale institutions, the average account size is usually below the minimum asset requirement). During the late 1990s, many banks moved down market and accepted clients who did not fulfil their communicated entry criteria. Also, at the industry level, entry thresholds do not tend to change much over time and have not generally kept pace with asset-price inflation: over the long term, real (i.e. inflation-adjusted) entry thresholds for many players have fallen.

There are generally no official government or private statistics on the actual distribution of wealth within individual countries. We are therefore forced to rely on estimates, which come in a variety of shapes and forms (see Box 1.1).

Micro, survey data are often unreliable. Not unnaturally, many individuals deliberately attempt to conceal the exact size of their wealth, and a large proportion of wealth may be held not only in secret accounts and trusts but also in assets that are illiquid and/or not publicly quoted. Furthermore, it is often difficult to draw a distinction between an entrepreneur's corporate and personal wealth.

Hence, in using these data, a 'health warning' applies: clearly, the output, in terms of the wealth estimate, can only ever be as good as the input, in terms of the data and analysis on which the estimate is based; the final estimates will be highly sensitive to the assumptions made; and there can, therefore, be substantial differences in estimates from different organisations. For example, Capgemini/Merrill Lynch estimate that global HNWI wealth as at end-2004 was \$30.8 trillion; the corresponding estimate from The Boston Consulting Group was \$24.5 trillion; and UBS's published internal estimate⁴ was \$35.4 trillion. There are also substantial differences within the regional breakdowns and dynamics (see Figure 1.5).

Box 1.1 explores some of the reasons for these differences and examines wealth market-sizing methodologies more generally.

⁴ Source: Presentation by Peter Wuffli, CEO, UBS, at Morgan Stanley European Banks conference, 22 March 2006, page 8. Estimate excludes real estate, private business interests, insurance and other illiquid assets.

Box 1.1 Wealth market measurement methodologies: lies, damn lies and wealth statistics?

Most estimates of the wealth market for a given country (or region) follow a two-step methodology:

- Estimate the stock of total wealth.
- Estimate how that wealth is distributed across the adult population.

To estimate the stock of total wealth, basic source data are typically available from national statistical offices, central banks and investment industry associations. In the absence of wealth-stock data, one approach is to cumulate national accounts-based private savings flow data. Another approach is to rely on the relationship between net private investment assets and nominal gross domestic product (GDP). For both approaches, the financial asset data are captured at book value, so a market-value adjustment is required, based on movements in equity, bond and real estate prices. To the extent that offshore investment flows are not accurately reflected in all national accounts data, a further adjustment will be required.

Total wealth is then distributed within each country using the relevant official statistics for those countries where such data are available. For countries without such data, estimates are made on the basis of the wealth distribution patterns of countries with similar income distributions. Income-distribution data can be summarised by the 'Gini coefficient', which measures the extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. The coefficient falls between zero for perfect equality and one for extreme inequality. Gini coefficients for individual countries vary between close to 0.25 for egalitarian high-income countries such as Japan and Sweden and close to 0.6 for Brazil, which is one of world's most inegalitarian countries. The World Bank (2005) provides estimates of the Gini coefficient for most countries in its *World Development Indicators* publication; its most recent estimates show the US coefficient as 0.41 and the UK coefficient as 0.36. (Calculating the Gini coefficient is based on the Lorenz curve, which plots the cumulative percentages of total income received against the cumulative number of recipients, starting with the poorest individual or household. The coefficient measures the area between the Lorenz curve and a hypothetical line of absolute equality, expressed as a percentage of the maximum area under the line.)

Within this general methodology, approaches vary, particularly with regard to how wealth is defined. For example:

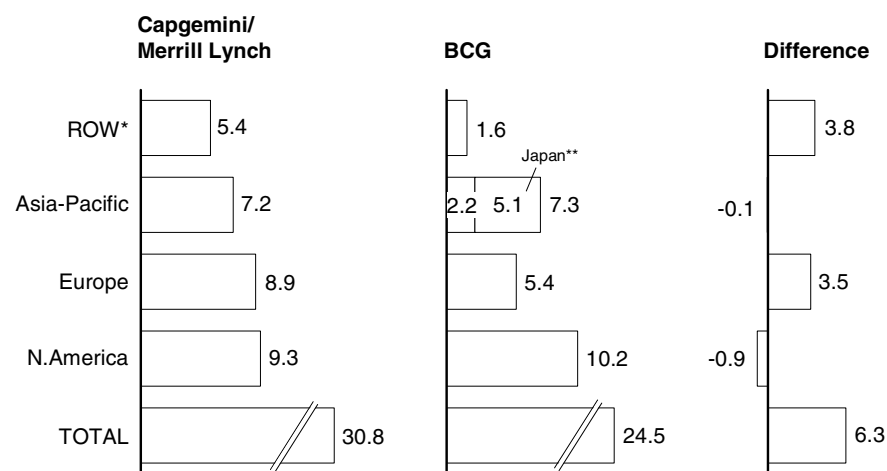
- The Capgemini/Merrill Lynch annual World Wealth Report defines the market in terms of individuals with financial wealth of more than \$1 million. Its data include private equity holdings as well as all forms of publicly quoted equities, bonds and funds, and cash deposits. It excludes ownership of collectibles and real estate used for primary residences. Offshore investments are theoretically accounted for but, in practice, only insofar as countries are able to make accurate estimates of relative flows of property and investment in and out of their jurisdictions. It accommodates undeclared savings in its figures. It applies the methodology to 68 countries, which account for 98% of global GDP and 99% of global equity market capitalisation.
- The Boston Consulting Group (BCG), in its most recent annual Global Wealth Report (2005), defines the market in terms of assets under management (AuM). For this it includes listed securities, held either directly or indirectly through managed funds, cash

deposits, and life and pension assets. For larger countries, for 2004 and also for past years, it calculates AuM based on national accounts and other public records. For smaller countries, AuM is calculated as a proportion of nominal GDP, adjusted for country-specific economic factors. It calculates market movements as the weighted-average price changes of the asset classes held by households in each country, factoring in both domestic and overseas equity and bond holdings. To identify asset-holding patterns across different countries and wealth segments, it uses national statistics. When such data are not available, it assumes that countries with similar cultures and regulatory environments have similar asset-holding patterns. BCG defines 'mass affluent investors' as those with \$100k–\$1 million in AuM, 'emerging wealthy investors' as those with \$1 million–\$5 million in AuM and 'established wealthy investors' as those with more than \$5 million in AuM. It now provides estimates for 62 countries.

- Datamonitor defines wealth by reference to onshore liquid assets only, including cash, equities, bonds and funds. Its typical approach is to use the UK as a base country: the UK is one of the few countries that has relatively robust liquid-asset distribution data (sourced from HM Revenue and Customs). For other countries, it calculates total wealth from public data sources, and then establishes a distribution for that wealth based on a skewed version of the UK's wealth distribution. The degree of skew applied is determined by a series of multipliers, which take into account factors such as population, asset holdings per capita and relative Gini coefficients. Datamonitor defines 'mass affluent' individuals as those with liquid assets of \$54k–\$360k, HNWI as those with liquid assets of \$360k–\$9 million and UHNWIs (ultra-high net worth individuals) as those with liquid assets of more than \$9 million.

HNW wealth, 2004

\$ trillion



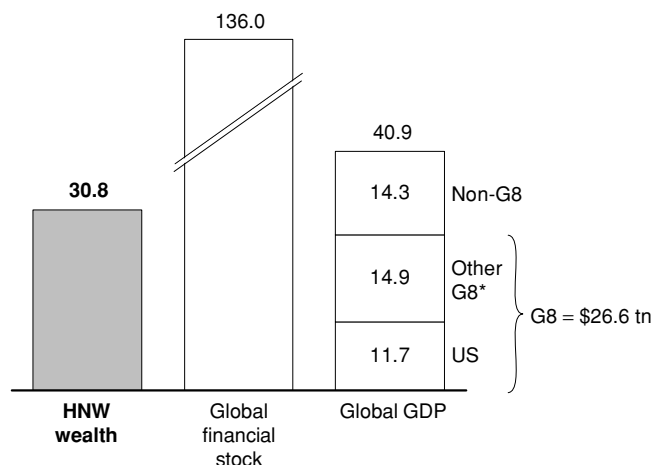
*Latin America, Middle East and Africa

**Not disclosed; estimate takes BCG's \$4.5 trillion estimate for 2003 (as published in *The Economist*, 10 June 2004), and assumes growth in line with that of non-Japan Asia

Figure 1.5 HNW wealth estimate comparison

Source: Capgemini/Merrill Lynch; Boston Consulting Group; *The Economist*; author's calculations.

2004, \$ trillions



*Japan, Germany, UK, France, Italy, Canada, Russia

Figure 1.6 Global HNW wealth in context

Source: Capgemini/Merrill Lynch; IMF; McKinsey Global Institute.

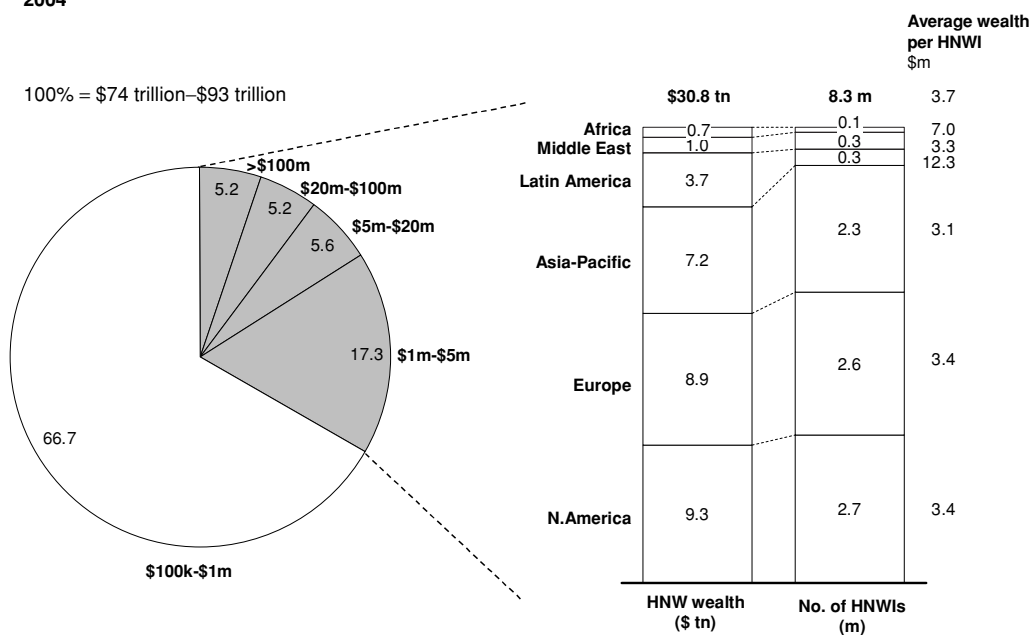
Regardless of the measurement methodology, the size of the wealth market is large. As Figure 1.6 shows, the stock of global HNW wealth represents around a quarter of the global financial stock (which includes all bank deposits, government and private debt securities, and equities). Also by way of context, HNW wealth is larger than the annual GDP of the G8, and is more than 2.5 times the size of US annual GDP.

Figure 1.7 shows that mass affluent wealth, i.e. the wealth of individuals holding \$100k–\$1 million of assets, makes up around two-thirds of the global wealth market. Turning to HNW wealth, as one would expect, North America and Europe currently dominate the market, accounting for 59% of the total, representing the wealth of 5.3 million millionaires. The average wealth of the world's 8.3 million millionaires is \$3.7 million, but Latin American and African millionaires stand out as having much higher average wealth levels.

How much wealth is booked or managed offshore? That is notoriously difficult to assess with much confidence – and, needless to say, estimates vary substantially. At one extreme, the Tax Justice Network estimated total offshore wealth as at end 2004 of c.\$11.5 trillion, or 37% of global HNW wealth, an estimate they consider conservative. Applying the indicative regional onshore-offshore splits given in Figure 1.3 yields an estimated total offshore wealth of c.\$7 trillion. The Boston Consulting Group estimate c.\$6.4 trillion, or 7.5% of total global wealth, in 2004.

In earlier work, BCG analysed the sources and destinations ('booking centres') of offshore wealth (see Figure 1.8). In terms of sources, they found that Europe accounted for more than half of the total, flowing mainly to Switzerland, Luxembourg and the Channel Islands. Geographic proximity appears to be a key driver in selecting an offshore destination: Latin Americans favour Miami, New York and the Caribbean; Asians favour Singapore and Hong Kong. But

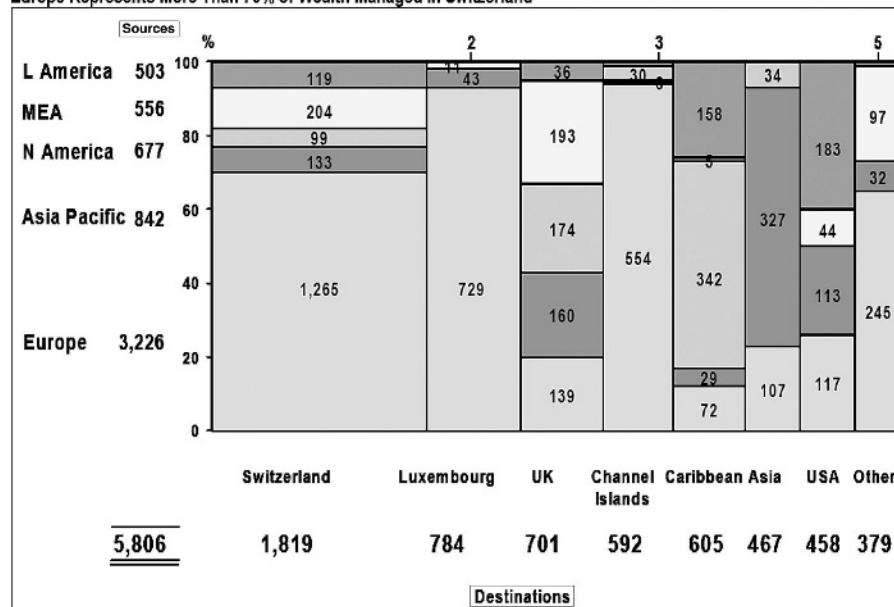
2004

**Figure 1.7** Global wealth by region and client wealth band

Source: Boston Consulting Group; Capgemini/Merrill Lynch; author's calculations.

Global offshore assets, 2003, \$ billion

Europe Represents More Than 70% of Wealth Managed in Switzerland

**Figure 1.8** Offshore wealth: sources and destinations

Source: Boston Consulting Group; Huw van Steenis, Morgan Stanley. Reproduced by permission.

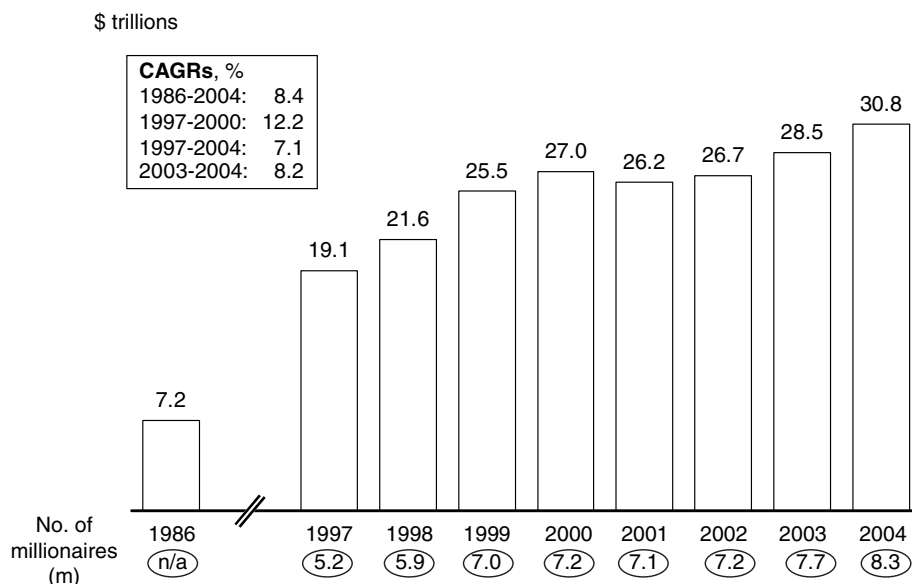


Figure 1.9 Growth in global HNW wealth

Source: Capgemini/Merrill Lynch 'World Wealth Report' (various years); author's calculations.

overall, Switzerland dominates the destinations, managing around one-third of total offshore assets.⁵

Since 1986, global HNW wealth has grown at a compound annual growth rate (CAGR) of 8.4% (see Figure 1.9), substantially higher than the 5.6% CAGR of global nominal GDP. Growth was particularly strong during the late 1990s, linked to strong growth in global equity markets in particular. Market growth faltered during 2000–2002, and there was widespread wealth destruction for the first time in recent history in 2001, driven by asset price falls and the global economic downturn. The market returned to growth in 2003, with further expansion in 2004. But recent growth at 8.2% is well down on that seen in the late 1990s.

Since 1997, the highest growth in wealth has been in Asia, followed by Europe and North America (see Figure 1.10). Recently, however, growth in the Middle East and Africa has picked up very strongly. Globally, the number of millionaires continues to grow at more than 7% a year – around 6 times the pace of the population as a whole.

1.2 KEY WEALTH DRIVERS

What are the key factors driving the growth in the wealth management market? These factors can be divided into a group of drivers that are common to all wealth markets, and those drivers that are region specific. In considering wealth market growth, it is useful to decompose it into appreciation of existing wealth, net new inflows from existing wealth owners and entry of new wealth owners. That, in turn, can have important implications for market accessibility.

There is also a group of less tangible factors at work. Kevin Phillips (2002) in his book, *Wealth and Democracy*, argues that a few common factors appear to support 'wealth waves',

⁵ Note that this analysis focuses on the *stock* of assets. As discussed in Chapters 9 and 10, the picture with regard to new offshore asset *flows* would look very different.

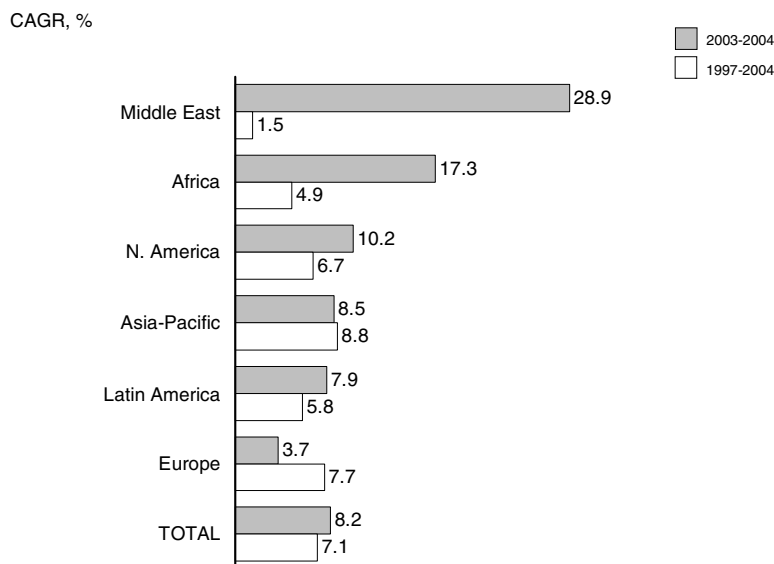


Figure 1.10 Growth in HNW wealth by region

Source: Capgemini/Merrill Lynch 'World Wealth Report' (various years); author's analysis.

including: a fascination with technology, creative finance, supportive government, the rule of law, patented inventions and an international dimension of immigrants and overseas conquests.

1.2.1 Generic drivers

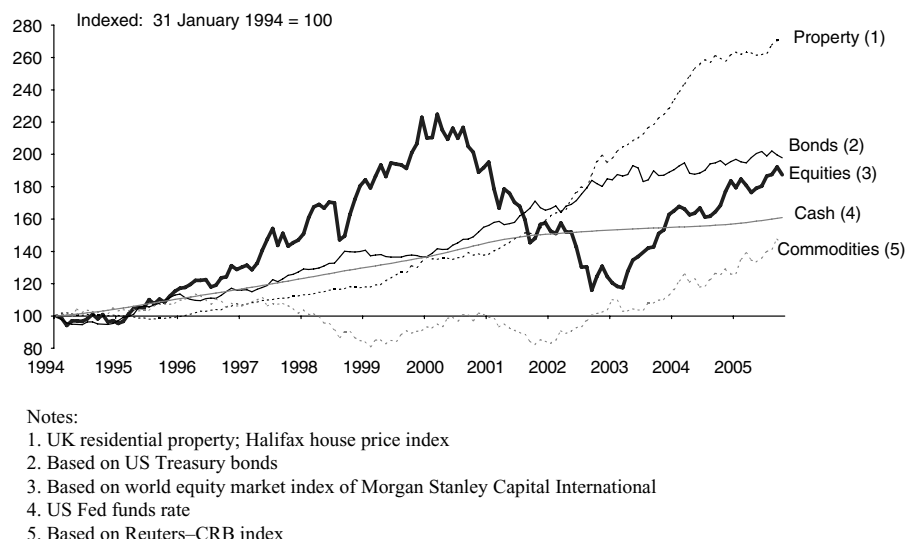
A key driver of the wealth management market is clearly the growth of wealth itself and how it is distributed. In principle, the revenues of most financial services are driven by 'surplus' wealth. As individuals grow wealthier, they make more use of financial services. Wealthy individuals invest and spend more, they seek more protection for their existing wealth and lifestyle, and they feel comfortable borrowing large sums of money. They also seek advice when addressing this collection of financial needs.

Growth in wealth, in turn, is impacted by four main generic drivers: economic growth, asset prices, wealth allocation and demographic factors.

1.2.1.1 Economic growth

From a long-term perspective, the key wealth driver is economic growth (which, in turn, ultimately helps drive asset prices). Within aggregate economic growth, its balance/composition, volatility and the pattern of productivity growth also have an impact on wealth creation and allocation.

Figure 1.11 shows that growth in global wealth has exceeded that of global GDP in recent years. Asia Pacific and Latin America stand out as having grown wealth well in excess of their GDP growth rates, while the opposite has been the case in the Middle East. Latin America also accounts for a disproportionately high share of global wealth relative to its share of global GDP; on the other hand, Europe's wealth share is disproportionately low.

**Figure 1.12** Selected asset prices

Source: Author's analysis.

Box 1.2 US Wealth Dynamics⁶**Recent trends**

Every year since 1982, *Forbes* has published data on what staff of that magazine estimate to be the wealthiest 400 people in the United States. The *Forbes* wealth data show strong growth *in real terms* across a variety of dimensions from 1989 to 2001. There are, however, some striking differences within the period and across different groups (see Table 1.1).

Table 1.1 The wealthiest 400 people in the US according to *Forbes*: wealth by rank and average wealth in millions of 2001 dollars

Wealth by Forbes rank	Year							
	1989	1992	1995	1998	1999	2000	2001	2002
1	7 106	7 746	17 002	63 214	89 716	64 318	54 000	42 361
10	3 417	4 303	4 940	11 907	17 943	17 356	17 500	11 723
50	1 736	1 537	2 068	3 139	4 222	4 798	3 900	3 152
100	957	984	1 034	1 840	2 533	2 654	2 000	1 773
200	615	584	689	1 028	1 267	1 531	1 200	1 084
300	478	430	500	731	897	1 000	875	763
400	376	326	391	541	660	740	600	542
Average wealth	921	937	1 025	1 997	2 731	3 057	2 366	2 148
Memo item:								
Number of billionaires	97	92	107	205	278	301	266	205

Source: Kennickell (2003); US Federal Reserve Survey of Consumer Finances.

⁶ This box draws heavily on Kennickell (2003).

From 1989 to 1995, overall mean Forbes wealth was relatively stable, as was the level of wealth at most of the ranks of the distribution of this population up to around the top 50. The top 50 showed substantial growth in wealth over this period. From 1995 to 1999, the entire distribution shifted up, particularly at the top. By 1999, the wealth of the wealthiest individual was 5.3 times larger than in 1995, while that of the tenth wealthiest individual was 3.6 times higher. Over the same period, the cut-off point for membership of the Forbes group rose 69%. After 1999, the top end led the way to a general downturn in 2001 that continued into 2002. Nonetheless, even at the end of the period, the entire distribution was significantly above the levels of 1989. The total wealth of the Forbes 400 as a proportion of total individual wealth ranged from 1.5% in 1989 to a high of 2.5% in 1998 to 2.2% in 2001.

The overall growth in the entire distribution of the Forbes wealth masked a considerable amount of composition churning. Of the 400 people in the 2001 list, 230 were not in the 1989 list. Even between 1998 and 2001, nearly a quarter of the people on the list were replaced by others. Although some of the movement is explained by the transfer of wealth through inheritance, the number of such instances appears to be small – only about 20 of the members in the 1989 list did not appear in the 2001 list. Others may have died and fragmented their wealth into pieces smaller than the Forbes cut-off. Persistence of individuals in the list was highest for people who were in the top 100. Of the people in the top 100 in the 2001 list, 45 were included in the same group in 1989 and 23 others were in the lower ranks of the list. Of the bottom 100 in 1989, only 29 remained in the 2001 list.

Historical perspective

Long-term historical wealth data are hard to come by, so most studies have focused on income. What follows focuses on data compiled by Piketty and Saez (2004). Figure 1.13 shows

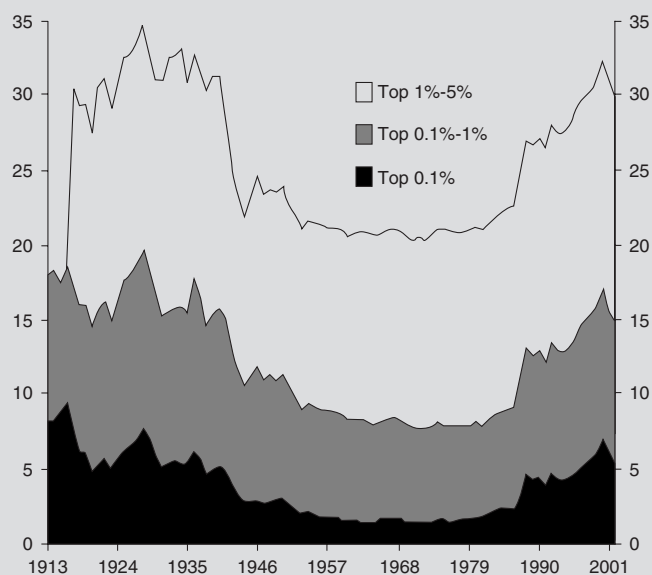


Figure 1.13 Income shares of highest US earners, percent
Source: Piketty and Saez (2004).

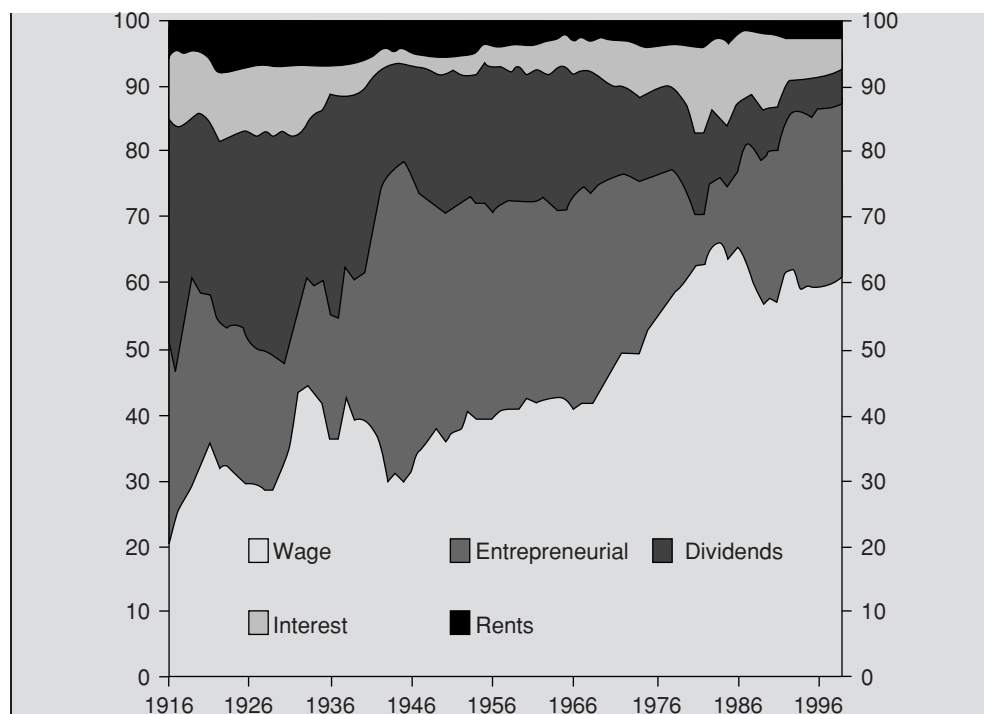


Figure 1.14 Sources of income, top 1% of earners, percent

Source: Citigroup Global Markets (2005), based on Piketty and Saez (2004).

the share of income for the top 0.1%, 1% and 5% since 1913. The fortunes of the top 0.1% (roughly 100 000 households) fluctuate the most, and account for the bulk of the movement of the top 5%. Between World War II and the early 1980s, all of their income shares fell, partly linked to loss of capital income and progressive corporate and estate taxation. But since then, the income shares of these groups have all reverted pretty much to where they were in the roaring 1920s, partly linked again to reductions in taxes. As Figure 1.14 shows, the way in which this income is earned has shifted, because in the earlier period, dividend and rental income were more important than they are now; wages and entrepreneurial receipts now dominate the income of the rich.

with levels of around 8% in Japan, France and Switzerland, for example.⁷ Take wealth, rather than income, and America's disparity is even more stark. In 2001, the wealthiest 1% of households controlled 33% of US wealth, while the lowest 50% of households held only 3%, according to the Federal Reserve.

The relative inequality in America reflects the people at the top doing unusually well. The top 10% of Americans are nearly twice as well off as the top 10% of Nordic households. They are also much further away from the US mean. As Robert Frank and Philip Cook (1996) point out in

⁷ The drivers of these differences are not entirely clear. Tax plays some part, but relative to the US, Canada is a high-tax country and Switzerland a low-tax one. To some extent, the figures may be distorted because they are based on tax returns and in some countries it is easier to park income offshore than it is in others. In addition, people move. There is, for example, a programme in France currently to try to persuade the rich to move back, as large numbers have apparently decamped to Belgium and the UK.

their book *The Winner-Take-All Society*, new technology, globalisation and market economics have changed the structure of many industries in such a way that their star performers now earn vastly more than the average. That has been most visible in sports (think golf, tennis, soccer, baseball and basketball stars) and the arts (think music, TV and movie icons, supermodels, designers, celebrity chefs, etc.), where the best can become global celebrities and typically earn far more than those who manage and advise them, whereas average performers receive only mediocre pay. Oprah Winfrey, who neatly combines both managing and performing in her company, Harpo Productions, became the world's first self-made billionaire in 2003. But superstar remuneration has also become widespread in less glamorous businesses, including law, investment banking and hedge fund management.⁸

Going forward, government policy, such as the tax policies of the Bush administration, will probably further exacerbate the wide gap between rich and poor. US inheritance tax has been all but scrapped. Marginal rates on top incomes have fallen. Most important may be the 2003 reduction in capital gains and dividends taxes, which will have a disproportionate impact on the top 20% of households.

Continued growth in income inequality is one factor that is expected to support greater future wealth concentration across the globe going forward.

1.2.1.4 Demographic factors

Demographics are also a powerful catalyst to wealth market development. The basic rationale is as follows. The age group that has generally mattered most to the industry from a growth perspective is those aged 45–64. These are the people who are most likely to be accumulating assets for retirement, while at the same time enjoying their peak years of earnings. Because of the baby boom that took place between 1946 and 1965, that age cohort has been growing rapidly from around 1991.

Economic and technological change has also been driving the recent growth in HNWI wealth and has led to a transformation in the profile of the contemporary wealthy individual. Entrepreneurial wealth has become increasingly important, while the significance of inherited wealth has declined somewhat.

Going forward, though, inheritance-related wealth transfers are likely to increase in importance and are expected to peak in 2015. It is important to note that this, of course, is not *new* wealth – merely a redistribution of existing wealth. The baby boomers are poised to benefit from a substantial generational transfer of assets as their parents leave inheritances that could, in the US, easily exceed \$41 trillion⁹ over their children's lifetime. Boomer parents enjoyed the strongest asset growth rate of any demographic group over the last decade. How these assets will be distributed among the boomer group, and what effect this pending transfer will have on boomer savings patterns and on the industry, both pre- and post-transfer, is not entirely clear. One suggestion is that it will create opportunities in two main ways:

1. 'Money in motion', a chance for wealth managers to grab share ('wealth redistribution') as clients potentially switch providers (one study, Grove and Prince (2003), found that a full 92% of heirs switch wealth managers after receiving their inheritance).
2. Expand the addressable market, because younger clients tend to use wealth managers more than their parents, who often hold securities directly.

⁸ Dew-Becker and Gordon (2005) show that corporate executives now account for more than half of the incomes of the top 0.1% of the US income distribution. The ratio of the pay of US chief executive officers to average wages rose from 27 in 1973 to 300 in 2000.

⁹ This is the lower-bound estimate of Havens and Schervish (1999), confirmed in their 2003 paper.

1.2.2 Regional drivers

Though there are clear differences among the drivers of wealth growth at the individual country level – reflecting, in part, different stages of market evolution and maturity – some regional patterns and stylised facts emerge. Wealthy clients' international lifestyles and business interests mean that a grasp of the regional dimensions is important to serve these clients well. Appendix 1 provides a more detailed country-by-country analysis.

1.2.2.1 North America: Industry shift towards full-service model

In the US and Canada, the key wealth drivers are well known. Chief among them are consistently high economic and productivity growth rates. Wealth has also been driven by strong US financial market returns,¹⁰ particularly equities, in which North American investors hold more than half their assets – far more than the global average. The bulk of the wealth is held onshore, reflecting low domestic tax rates and general economic stability. Though the early phases of economic development were dominated by family businesses, start-up businesses have grown significantly since the 1980s. In the 1990s, there was a further pick-up in the number of entrepreneurs, and the booming IPO market turned many of them into instant millionaires.¹¹ Most recently, for example, the August 2005 IPO of Google, the Internet search engine company, is reported to have created 5 billionaires and 1 000 millionaires.

The bulk of America's wealthy individuals and families are self-made. During the period from the early 1950s to the mid-1970s, many millionaires were senior corporate executives. However, from the early 1980s the bulk of the newly created wealth has come from entrepreneurs; the market was given a boost during the mid-to-late 1980s as there was a tendency for wealth to be liquidated through leveraged buyouts. The majority of these wealthy individuals are retired business owners, corporate executives or other professionals. A third of respondents to US Trust's June 2002 Survey of Affluent Americans emphasised earnings from corporate employment, private business, professional practice and securities; a quarter emphasised real estate. By far the least important source of wealth was inheritance.

Demographic factors have also played a strong role. There are around 60 million US baby boomers at present, and the cohort is likely to continue growing for the next decade to around 80 million.

US UHNW wealth has recently been growing particularly strongly. Many of the wealthiest families have their own private investment offices, or 'family offices', with a staff of professionals providing a variety of wealth management services.

1.2.2.2 Western Europe: Wealth transfer between generations

Western Europe is one of the most mature wealth management markets. In contrast to the US (see Figure 1.15), it includes a significant proportion of global 'old' wealth – associated with inheritance and more traditional forms of asset growth rather than entrepreneurial wealth creation. A significant proportion of industrial companies remain privately owned, particularly in Germany and Italy. That, together with a tendency for wealth to be tied up in land and property in some countries in particular, has contributed to a degree of wealth illiquidity in

¹⁰ Domestic financial market returns are relevant because of investors' well-documented home bias.

¹¹ During this period, Silicon Valley originated a term to describe the sort of money that frees an individual from ever having to work again: 'fuck-you money'.

Key Differences between North American and European HNWI's



North America	Europe
	
<ul style="list-style-type: none"> • Capital market-led, participating in strong equity culture • Wealth sources: Highly entrepreneurial, emphasis on technology and finance • Average HNWI age 55–57: <ul style="list-style-type: none"> – Distributed down through younger age bands – Increasing female component • Trend towards one principal provider and a more holistic approach • Domestically focused equity culture, mainly in onshore vehicles 	<ul style="list-style-type: none"> • Banking-led, protecting capital from war, hyperinflation, and high taxation • Wealth sources: Inheritance and multiple sectors, including retailing and manufacturing • Average HNWI age 59–62: <ul style="list-style-type: none"> – High concentration in upper age bands – Fewer females • Use multiple providers and a less integrated approach • More balanced across asset classes; stronger offshore flavour

Figure 1.15 Key differences between North American and European HNWI's

Source: Capgemini/Merrill Lynch 'World Wealth Report', 2002.

this region. A challenge for private banks with clients in this region is to develop tools for harnessing this wealth.

A significant proportion of European wealth is managed offshore. That reflects relatively high tax rates in most European countries, political instability in some countries and weak domestic investment opportunities.

Until recently, many of the larger individual private banking accounts from this region consisted of fortunes made two or three generations ago with very little new capital being added. It is quite common for individuals who play an active role in the running of their companies to delegate the management of their wealth to private banks or other professionals. In general, private banking clients from this region have tended to be conservative investors.

BCG note that, after several years of decline, exposure to equities throughout Western Europe has stabilised at around 32% of assets, though some countries, such as the UK and Switzerland, have significantly higher shares. A relatively large proportion of Western European wealth is held in property, shipping and privately held businesses. Going forward, intergenerational wealth transfer will be particularly important in this region.

1.2.2.3 Central and Eastern Europe: Strong economic development

There are several key structural drivers of wealth creation in Central and Eastern Europe. Clearly, the stabilising political and economic environment in the post-communist era has

been supportive. For some countries in the region, the prospect of European Union (EU) accession, with its associated real economic convergence, has led to high, sustained growth over recent years. That, in turn, has been a result of capital availability (including foreign direct investment, EU structural funds, domestic investment and saving) and gains in capital and labour productivity (linked, in part, to privatisation and restructuring).

Poland, Hungary and the Czech Republic, for example, have recently benefited greatly from an influx of foreign capital as the last hurdles to full membership of the EU were removed. In 2004, GDP growth averaged 4.3% in these countries. Simultaneously, Russia continued the impressive recovery from its late 1990s financial crisis, posting GDP growth of 7.2%; that, combined with the oil price rise, has generated very strong growth in the local equity market.

That the early stages of the transition from communism to market-oriented economies allowed many opportunists to get rich quick is well known. Some did so honestly but, as *The Economist* put it, 'many more cheated, bribed and stole from the state or small investors, using conniving banks as a source of everlasting loans and a place to wash their money'.

In Russia, the wealth market has been supported by a slew of IPOs and by the recent oil price rise, which has helped stabilise the economy, given that it is the second-largest oil exporter in the world. But political instability, and a lack of services aimed at long-term wealth preservation and wealth transfer, have traditionally driven much of the wealth offshore. The Russian Finance Ministry officially projects that capital flight will rise to \$10 billion in 2005.

Throughout the region, there is also a legitimate – more onshore-oriented – affluent middle class emerging, supported by market liberalisation, low inflation and interest rates, steadying local currencies, higher risk-adjusted local returns, a growing number of entrepreneurs and small businesses, and broad-based increases in real disposable income. Eastern Europe's newly affluent people are younger, better educated, more familiar with technology and more likely to be entrepreneurs – with an associated greater appetite for credit – than their counterparts in the West.

1.2.2.4 Asia-Pacific: Strong economic development

Strong economic growth and development across Asia has led to considerable wealth accumulation, mainly over the last 25 years. That growth has been supported by high savings rates, young and productive populations, and strong inflows of foreign direct investment.

A key contributory factor has been intense regional entrepreneurial activity, particularly in real estate, banking and trading-related businesses. Throughout the region, some 500 million people are employed in non-agricultural sectors. Of these, around 60% work in small and medium-sized businesses. The entrepreneurs who run these businesses have generally fared well in Asia's rapidly expanding economies.

The ethnic Chinese (diaspora) population stands out as being particularly successful in accumulating wealth. In Asia, there are currently around 2 million Asians of Chinese descent, driven by the large waves of emigration from mainland China during the twentieth century. Initially, they were banned from owning land and often barred from entering local politics, so local commerce and regional trade were their only options. But Chinese communities have consistently managed to turn adversity into prosperity. The cumulative impact of Chinese diaspora accomplishments are dramatic. In Thailand, for example, they comprise 10% of the population, but hold up to 80% of the wealth.

Many individuals throughout the region became wealthy simply by having had family land on the outskirts of Asia's fast-emerging cities. For example, it is not unusual in places like Taiwan or Hong Kong to encounter families whose net worth exceeds US\$10 million simply as

a result of having owned a plot of land bought before the 1970s, and sold after the mid-1980s. From the mid-1980s, and prior to the 1997–1998 crisis, real estate and financial asset prices rapidly appreciated in the region and capital markets boomed.

The Asian crisis of 1997–1998 had uneven effects within the region. South Korea and Taiwan were particularly affected, but it did not significantly affect Australia or China. For the region as a whole, the number of wealthy clients and their wealth remained remarkably stable over this period. The crisis did have the effect of increasing the investment conservatism of many clients, which enabled them to cope much better with the recent global equity market falls of 2000–2002. Most Asian assets are still held in cash, with equity exposure currently only around 28% of total assets. Most recently, China's huge export industry, along with many successful IPOs of Chinese companies in Hong Kong and New York, have been key wealth drivers.

Indian wealth has been driven mainly by very high economic growth in recent years, which has averaged 6.1% since 1995. India is now a major hub for outsourcing and global manufacturing, linked to its highly skilled workforce. Another driver is India's very high personal savings rate and, more generally, the current and prospective economic deregulation. The 20 million non-resident Indians (NRIs) around the world include around 150 000 dollar millionaires, and represent a particularly attractive segment. NRI remittances and asset repatriation have picked up sharply in recent years as they seek to take advantage of attractive domestic investment opportunities. Other wealth segments include entrepreneurs, corporate executives and professionals.

1.2.2.5 Latin America: Traditional offshore-banking stronghold

Rapid expansion and modernisation of Latin American economies over the last decade has resulted in a substantial increase in personal wealth. Tax systems in the region are, in general, not effectively redistributive so this newly created wealth is very unequally held. World Bank data show that Latin America has the greatest degree of income inequality in the world, with the top 10% of income earners accounting for around 45% of total income (compared to 30% in the US and around 25% in Europe and Asia-Pacific).

Latin American governments have been privatising state assets by selling off state-owned companies. They have also been loosening capital controls, eliminating export taxes, lowering trade barriers and opening up their banking systems to market influences. That, in turn, has encouraged repatriation of capital and boosted foreign direct investment. In Brazil, for instance, investors have recently been allowed to invest more freely abroad. As a result, lower yield and lower risk investments in bank deposits and bonds have been falling from favour.

Investment in local markets has grown, as confidence in some local economies has hardened. Increasingly benign government attitudes towards foreign investors has provided the opportunity for families in the region to increase liquidity by selling family-owned businesses to international investors and multinational companies. For example, in May 2001, Citigroup acquired the first-generation family-owned Grupo Financiero Banamex-Accival, which was Mexico's second-largest bank. During the 1990s, regional capital market development and high equity market valuations encouraged some family-owned firms to seek market listings. Growing numbers of entrepreneurs (e.g. in the offshore trade assembly and services sectors) have also been generating new sources of wealth.

Overall, these drivers mean that Latin America has many substantial wealth management clients. Unlike the rest of the world, Latin America's small pockets of relatively immobile, concentrated wealth have provided an easily identifiable client segment for local and foreign

banks to pursue in each country in the region. So far, wealth managers have generally focused on the HNW, rather than the affluent, market, which is not growing as rapidly as in other developing countries.

Though Latin America made substantial progress in handling its macro economy during the 1990s, sustained economic growth and political stability have remained elusive. Mexico, Brazil and, most recently, Argentina have lurched from one financial crisis to another.

Capital preservation has always been the ultimate goal of most Latin American private banking clients. For decades, Latin American HNW investors have been eager to get their money out of their countries and their region. They considered their home and businesses more than ample exposure to their volatile domestic economies and were interested only in the most conservative and discrete US, European and offshore investments. Latin America has very low equity exposure (BCG estimates 14% of total assets in 2004), with the bulk of assets held in fixed income and cash instruments.

Today, however, there appears to be a new willingness among some clients to keep at least part of their money at home. Domestic onshore investment has grown in popularity somewhat as governments try to create a more favourable tax and regulatory environment. Clients have shifted from traditional offshore private banking products to integrated, global solutions that address a complex set of business and personal needs across their entire balance sheet – not just the offshore portion.

There are, however, considerable differences among countries. Real GDP grew by c.4.5% in Mexico and Brazil in 2004, supporting wealth levels in those countries. At the other extreme, Argentina has suffered the greatest value destruction, with a large currency devaluation and a massive default on government and corporate debt in early 2002; its economy shrank at an average rate of 5% a year between 1999 and 2002, though growth has since rebounded strongly. Separately, the oil crisis in Venezuela in 2002–2003 sparked a recession that inhibited wealth generation there, though the economy is now recovering. Onshore providers in these countries have therefore downsized dramatically.

Overall in Latin America, political and economic instability have continued to drive wealth offshore. Latin American clients have generally booked their offshore assets in the United States, the Caribbean or Switzerland. There has been a shift recently towards booking more assets in Switzerland due to the increased transparency requirements under US legislation (e.g. the US Patriot Act – see Chapter 9).

1.2.2.6 Middle East: Oil-driven growth

The wealth of the Gulf region, both public and private, has derived almost entirely from oil and other natural resources such as gas, as well as from property and land. The oil boom reached its peak following the price shocks of the 1970s, creating a vast amount of prosperity. Sustained GDP growth has also supported wealth creation. The region's non-oil exports are small, even though countries such as the United Arab Emirates and Iran have successfully diversified their economies.

Wealth in the Middle East is highly concentrated and predominantly in the hands of relatively few families, who invest mainly in their own businesses. These family businesses act as agents, diversifying into other sectors of the economy and building a chain of dependencies. The majority of these families have inherited their wealth over several generations and continue to control large segments of the domestic economy. Financial institutions managing private wealth have recognised this and have started to meet the needs of these clients by establishing family offices (see Chapter 6). Some of these offices have

been known to employ 50 or more people in several locations in the Gulf, Europe and the US.

There are five broad categories of Middle Eastern wealth:

- Classical inherited wealth accumulated over several generations. That is by far the most common form of wealth. This segment mainly consists of long-established wealthy Middle Eastern families who are part of the rulers of the region.
- First-generation oil wealth. These holders of 'old money' tend to be conservative in their choice of overseas investments, with a preference for cash deposits, bonds and real estate.
- Younger generation family businesses. These are usually enthusiastic investors who have been to business school in the US or Europe. Many of them have evolved through the growth of the non-oil sector, including entrepreneurs, traders and holders of important franchises.
- Female inheritors. With the shift of affluence beginning to take place, mainly due to the death of one generation, there are now growing levels of wealth in the hands of women.¹² Views differ as to how much real control and influence these women have over their financial affairs. But there is a growing level of competitive activity in connection with this segment, suggesting that there are enough women who control their own wealth to present a sustained marketing opportunity.¹³ An indication of this is the increased presence of female bankers in the region, particularly in the Gulf and Saudi Arabia, where women in business are an innovation.
- Funds held in Islamic institutions. Since its beginnings in the 1980s, the global pool of funds being managed according to Islamic principles¹⁴ now totals around \$265 billion. Islamic banking services are in high demand in the Middle East and constitute a rapidly growing segment of the market (see Chapter 4). In Saudi Arabia, for example, Islamic mutual funds have grown at an annual rate of more than 20% over the past few years and now account for some 60% of the total mutual fund market.

Much of the region's wealth has traditionally been held offshore ('petrodollars'). That reflects regional economic and political instability, underdeveloped local financial sectors and, in some cases, the need to support international lifestyles. Most recently, the region is experiencing wealth generation not seen since the 1970s, primarily driven again by the growth in oil revenues.¹⁵ The pick-up in oil revenue initially drives increases in public-sector infrastructure spending and employment which, in turn, feeds through to benefit entrepreneurs, importers and property developers. McKinsey estimates that close to half of new wealth is currently staying onshore, with half of that wealth invested in local equity markets, which have shown staggering gains in recent years.¹⁶ Other recent drivers of wealth market development include greater intra-regional and international economic integration, and the development of domestic financial and other asset markets.

¹² In Islamic law, daughters as well as sons inherit, although unequally, on the basis of one part to two parts in the son's favour. Where cross-border wealth is concerned, the beneficial owner dictates how the wealth is distributed, and some international wealth managers detect that a more even-handed approach is now being taken.

¹³ In Saudi Arabia, women own 40% of private wealth and account for more than 50% of university graduates – a situation that is unique in the Arab world. Yet they make up only 5% of the country's workforce.

¹⁴ The conviction underpinning Islamic banking is that investments should be put to productive rather than speculative use and that a lender, instead of charging interest, should be compensated with a share of the profits—See Box 4.1 on Islamic Private Banking.

¹⁵ The Middle East accounts for around 65% of global oil exports. In 2005, global oil export revenue more than doubled, and in real terms is now well above its previous 1980 peak. For oil exporters, the current oil shock is in real terms slightly larger than the shocks of the 1970s. See Chapter II of IMF (2006a).

¹⁶ In the two years to September 2005, annual growth in local equity markets averaged 101% in the UAE, 80% in Saudi Arabia, 75% in Qatar and 49% in Kuwait. There have since been partial reversals in most markets – see Box 3 in IMF (2006b).

1.2.2.7 Africa: Commodity-driven growth

Africa has, in recent years, experienced relatively robust growth in wealth volumes and client numbers. That has primarily been driven by oil- and other commodity-related revenues. Other drivers include the pick-up in GDP growth, higher foreign direct investment, the relatively strong performance of local stock markets and local currency appreciation.

The African wealth market is dominated by South Africa, which accounts for around 60% of the region's wealth and has more than 35 000 HNWIs. Other key markets include Nigeria and Egypt. The ruling class, corporate executives, professionals, small and family-run businesses and, in some countries such as South Africa and Botswana, an emerging middle class represent the key target client segments. The bulk of African wealth is held offshore, mainly driven by political and economic instability. The region's wealth is highly concentrated, with levels of inequality very similar to those of Latin America.

1.3 INDUSTRY ECONOMICS

While, again, it is difficult to generalise, this section outlines some stylised facts on wealth management economics. At least on the face of it, the economics of the wealth management industry are extremely attractive, reflecting five key factors:

1. *Large and growing market.* Given the size and growth metrics outlined above it is unsurprising that wealth management is big business. It accounts for a disproportionately large share of the assets under management, revenues and profits of the personal financial services industry – up to 80% of the personal financial services profit pool in Europe, for example (Figure 1.16). Wealth management is also attractive relative to many other areas of financial

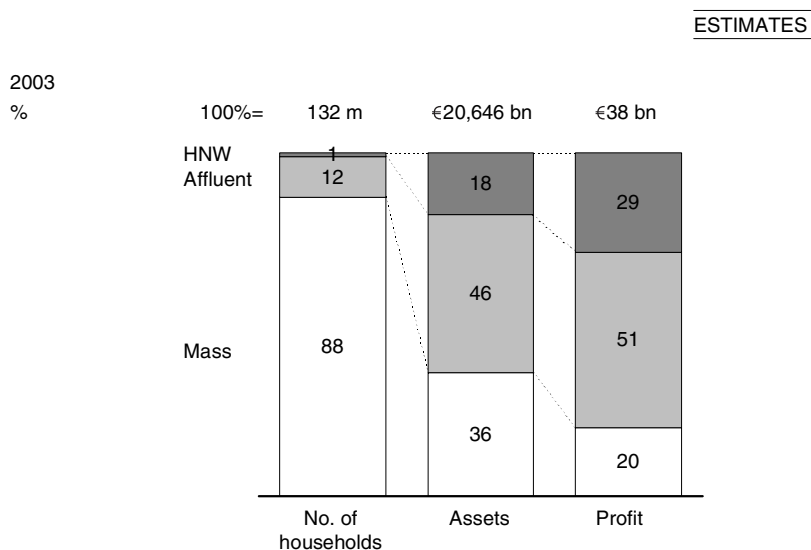


Figure 1.16 Wealth management component of personal financial services Europe
Source: Boston Consulting Group; author's calculations.

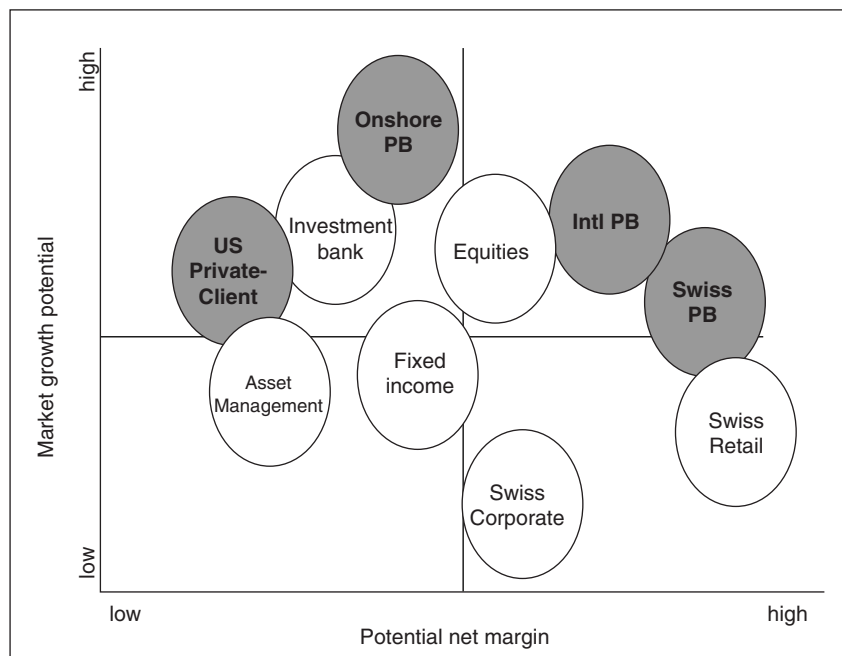


Figure 1.17 Relative attraction of wealth management

Source: UBS investor presentation.

- services (Figure 1.17). Citigroup estimates that, globally, wealth management accounts for 20% of the financial services revenue pool, which is higher than investment banking.¹⁷
2. *High profitability.* This reflects two factors. First, net profit margins are relatively high. Most wealth management players achieve 25 basis points or more, compared to around 5 basis points for institutional asset management (though institutional earnings are arguably even more sticky). Second, regulatory and economic capital requirements are low, linked to very little credit and market risk and a limited need for an extensive branch network. Indeed, on a risk-adjusted basis, wealth management profitability can be spectacularly profitable (see Figures 1.18 and 1.19).
 3. *Stable revenue stream.* This reflects a high proportion of fees in the revenue mix, in contrast to more volatile net interest or trading income. When combined with traditionally loyal client relationships, this yields a recurring source of income and cash flow akin to an annuity (Figure 1.20).
 4. *A relatively high stock market rating.* The strong economic fundamentals of the industry are reflected in its valuation metrics and implied growth expectations. A premium P/E relative (i.e. the price-earnings ratio of wealth managers relative to that of the market as a whole) of around 1.2 is the norm, compared with a relative of around 0.8 for the financial sector as a whole (Figure 1.21). The best recent example of this is EFG International (see Box 6.1), which was valued at 12% of AuM at the time of its IPO (October 2005).

¹⁷ BCG (2005c) estimated the global banking industry revenue pool as \$2 057 billion in 2004, split as follows: retail banking 52%, corporate banking 20%, wealth management 12%, investment banking 9%, and asset management 7%.

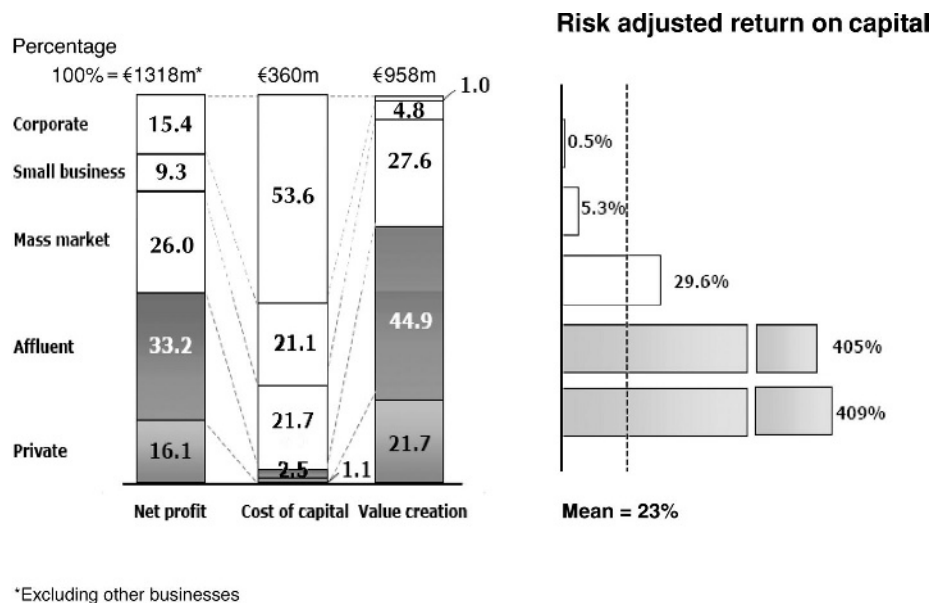


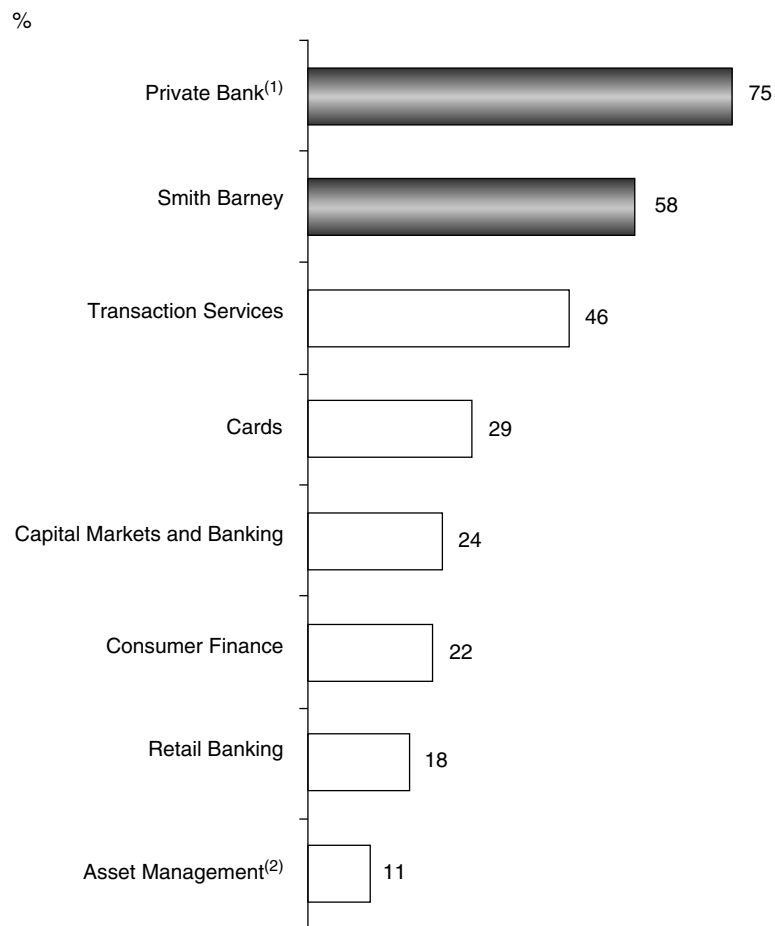
Figure 1.18 Wealth management profitability
Source: UniCredito Italiano investor presentation, 19 June 2001.

At the time of writing (March 2006), it was trading on c.62 times trailing earnings per share.

5. *Strong intragroup synergies.* Integrated players benefit from their wealth management businesses in two ways. On the revenue side, there are opportunities for wealth management operations to acquire clients from other parts of the group, e.g. the retail and business banking divisions. There are also opportunities for other parts of the group, e.g. investment banking divisions, to leverage the private client base for product sales. On the cost side, there are opportunities to share infrastructure and spread fixed costs, for example (see Chapter 8).

Wealth management economics have four simple components: assets, leverage, fees and costs. From the wealth manager's perspective, an attractive wealth management client has assets that comfortably exceed the stated minimum requirement, that grow steadily with limited volatility and that are invested under a discretionary mandate which produces recurring annual fees. A very attractive client will actively trade a portion of their assets, thus generating additional commission revenue. The truly ideal client will borrow against existing assets to increase the leverage of their investments, with little risk to the bank. If the client is financially sophisticated and understands the products reasonably well, an active portfolio can be effectively managed by a strong relationship manager with reasonably little time devoted to each client. If all goes well, such an account will reward the wealth manager with referrals to other wealthy clients.

Steady assets, consistent revenue streams, a low cost per account and a flow of new business introductions is a strong combination for wealth management economics. These objectives are not incompatible with serving the client's best interests, as long as adequate time is spent up-front to define the client's investment objectives, risk tolerance and service preferences.



(1) Private Bank ROIC excluding Private Bank Japan Discontinuation Charge of \$ 244MM after tax.

(2) Asset Management ROIC excluding Transfer Agent Settlement of \$ 151MM after tax.

Note: Does not include Life Insurance & Annuities and Proprietary Investment Activities.

Figure 1.19 Post-tax return on invested capital, 2004

Source: Citigroup.

1.3.1 Value drivers and key performance indicators

Wealth management's basic value drivers divide into two: the net profit margin and assets under management (AuM). Figure 1.22 provides a simple value-tree framework. This framework can be applied to decompose current valuation or to identify the drivers of change in valuation over time. On the latter, recent McKinsey European survey evidence shows that, at the aggregate level, revenue generation rather than cost efficiency has been the most critical factor. Within AuM, market performance rather than net new money or a greater share of wallet has been the dominant factor.

Gross revenue margin

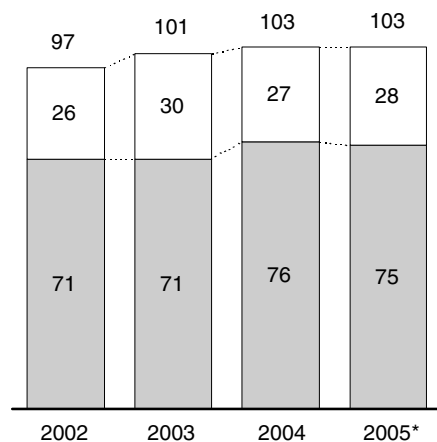
Basis points

Type of revenue:

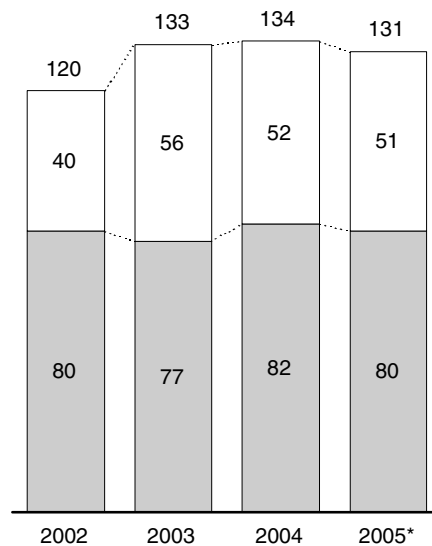
■ Recurring

□ Non-recurring

UBS



Credit Suisse



*Q1-Q3 average

Figure 1.20 High proportion of recurring income: large Swiss bank examples

Source: Company financial reports.

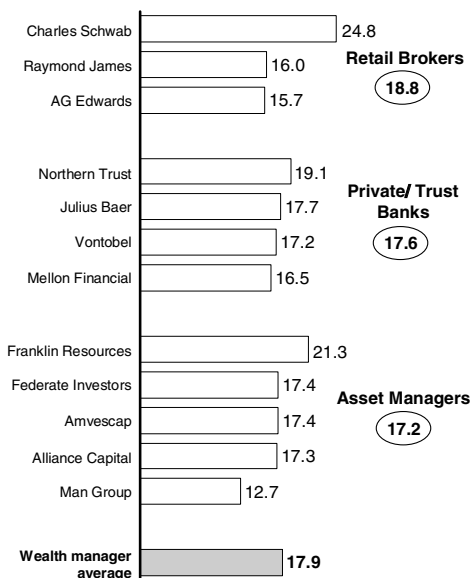
Specific key performance indicators (KPIs) should be tailored to the wealth manager's individual circumstances. They should also be systematically tracked over time and, where possible, benchmarked against competitors.

Surveys have found that healthy profits can be generated across a range of different wealth management business models. The quality of execution is a key differentiator; other factors influencing wealth management economics include:

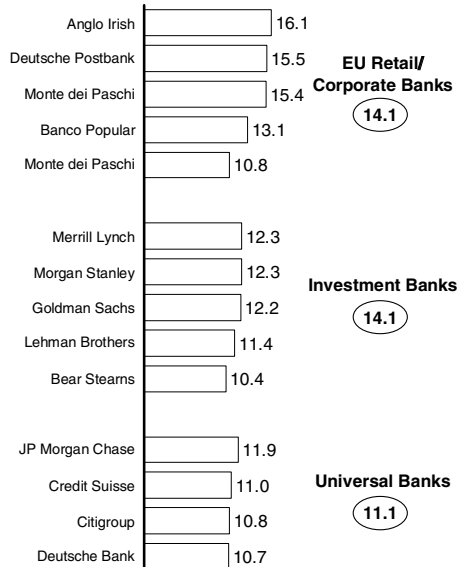
- *Level and volatility of asset prices.* Indeed, following the post-2000 equity market correction, one UK bank analyst remarked that 'wealth-management economics boil down to a small number times the equity market, less a big number (fixed costs)'. There is more than a grain of truth here as weaker financial markets exposed the fragility of many wealth management models. Merrill Lynch estimated that private banking profits fell by 20% a year on average between 2000 and 2002, driven mainly by falling asset-related revenues and sticky costs. Over that period, private banks' average cost-income ratio surged from 57% to 71%.
- *Scale.* Are there economies of scale in wealth management? As Raoul Weil, head of Wealth Management International, UBS, recently put it, 'Very wealthy clients do not want to entrust their fortune to a bank whose balance sheet is smaller than their own!' (IBM Consulting Services, 2005, p.80). Larger wealth managers certainly weathered the recent downturn better than the smaller firms. To some extent, this reflects their more diversified revenue

Multiples

Wealth management 'pure plays'



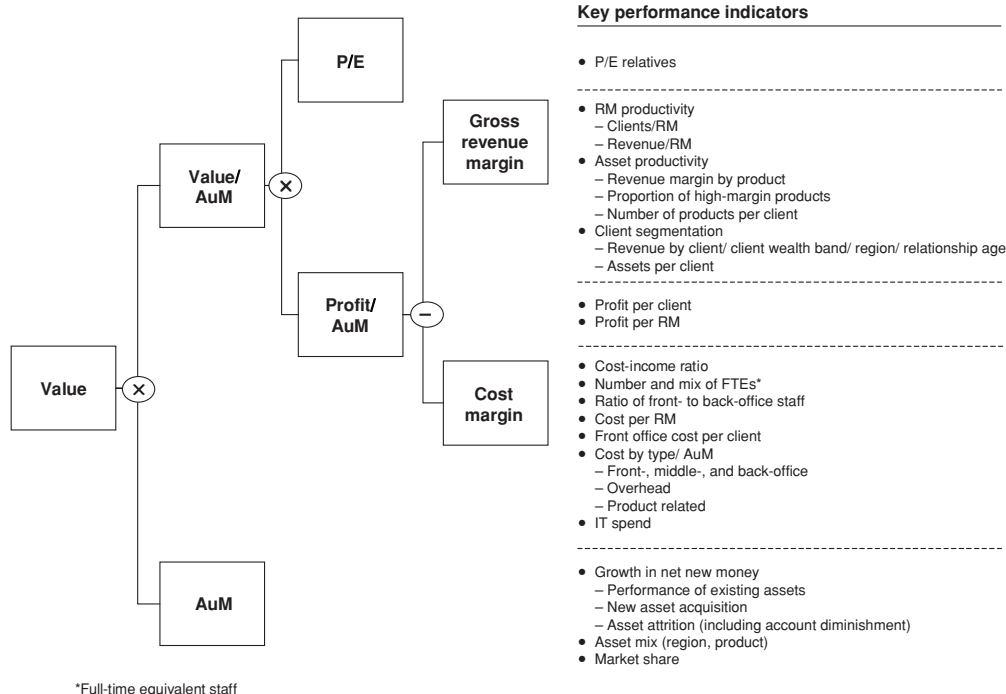
Other financial services players

**Figure 1.21** Financial services price-earnings ratios, 2005

Source: UBS; IBES; author's analysis.

streams. They also benefited from a 'flight to size', as heightened risk aversion led investors to seek comfort in institutions perceived as being systemically too important to fail. But recent survey evidence shows that smaller players appear to have a *structural* disadvantage with regard to profitability (see Figure 1.23). BCG has said that players with more than \$10 billion–\$15 billion of AuM are not demonstrably subscale. In IBM's 2005 European Wealth Management and Private Banking Industry Survey, 20% of respondents claim that the minimum threshold is €20 billion, with another 20% of respondents putting it at €50 billion. Larger firms have more bargaining power (and more resources to conduct due diligence) in product sourcing, have greater access to growth markets and, in the case of integrated providers, can lower their client-acquisition costs by using other parts of the group as client-feeder networks. That has contributed to their ability to achieve superior growth in net new money. On the other hand, as an institution grows beyond a critical size, clients can become more wary of potential conflicts of interest; client service quality – which remains the industry's key hallmark – can suffer ('I've become a number', an issue that can apply as much to relationship managers as to clients); greater bureaucracy can increase staff turnover; and the institution can become inherently more difficult to manage. Traditionally, private banking has a reputation for being a non-scalable industry. To the extent that there are economies of scale, most are likely to be found in the back office (see Chapter 7). The Swiss Banking School's International Private Banking Study 2005 (Cocca, 2005) concluded: 'Overall there seems to be some evidence for a moderate level of economies of scale in terms of profitability. However, size [in itself] has no significant influence on efficiency.'

NOT EXHAUSTIVE

**Figure 1.22** Wealth management value drivers

Source: Author's analysis.

- **Business model.**

- Onshore versus offshore models.* Margins tend to be higher offshore than onshore (see Figure 1.24), reflecting a number of factors. In the offshore business, clients are often less price sensitive and less focused on investment performance; there is a lack of aggressive competition; and client and asset loadings per relationship manager tend to be higher (linked to less frequent client interaction and the prevalence of 'suitcase banking'). In the onshore business, competition is more intense from both incumbents and new entrants; players compete more on price; and costs are higher. Offshore margins are often used to cross-subsidise onshore efforts.
- Fee- versus commission-based models.* Fee-based models are inherently more stable than commission-based models, which are driven by clients' trading activity. At least in part, that helps to explain why private banks generally have superior economics to those of brokers (see Figure 1.25). Other factors include higher average assets per relationship manager and a lower compensation–revenue ratio. Many US brokers are, in fact, actively focusing on boosting fees, which now account for more than half of total revenue for some players (see Chapter 6).
- Target client segment and client mix.* Economics vary significantly by client wealth band (see Figure 1.26). Revenue margins tend to be lower for wealthier clients, linked to their greater bargaining power, financial sophistication, more product/deal-driven approach and price sensitivity. Yet for some players, the costs of maintaining a large

Profit margin
Basis points, 2003

Maximum
Average
Minimum

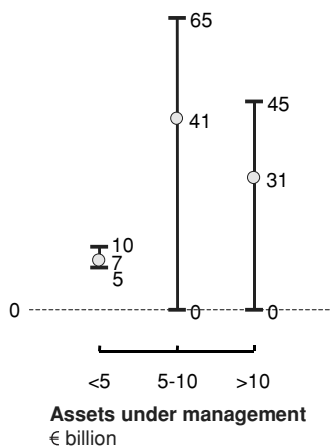


Figure 1.23 Wealth management economies of scale: European survey

Source: McKinsey European Private Banking Economics Survey 2004. Reproduced by permission.

number of low-growth small accounts can offset any revenue advantage, and many of the very wealthiest clients can also be very expensive to serve. Sitting between these extremes, there is a ‘sweet spot’, which may be client asset levels of around \$1 million–\$5 million. But it is important to note that *any* client wealth level can, in principle, be profitable. Wealth managers need to pick their target client segments and then tailor their

Profit margin
Basis points, 2003

Maximum
Average
Minimum

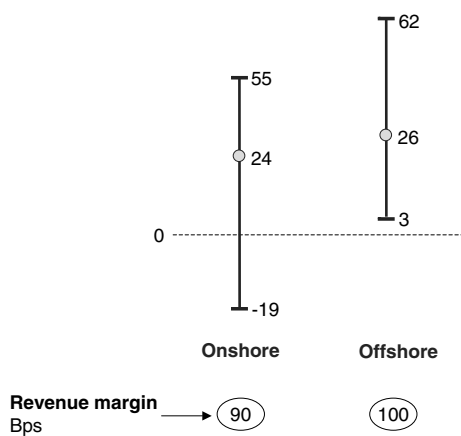
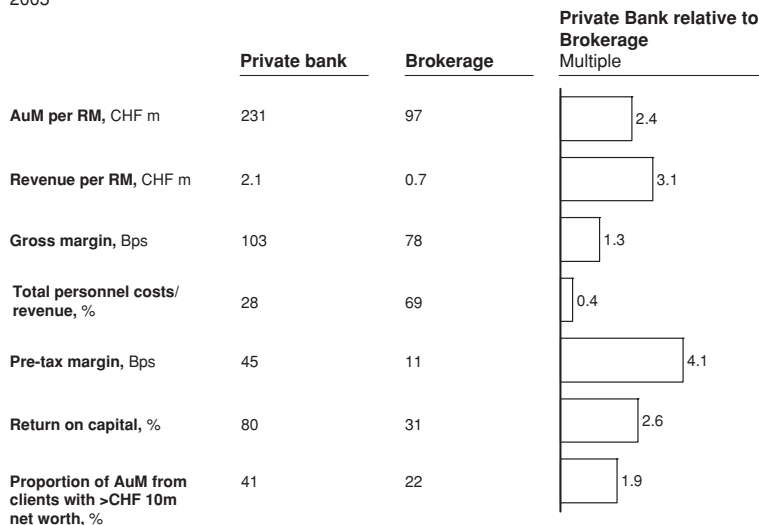


Figure 1.24 Offshore versus onshore economics: European survey

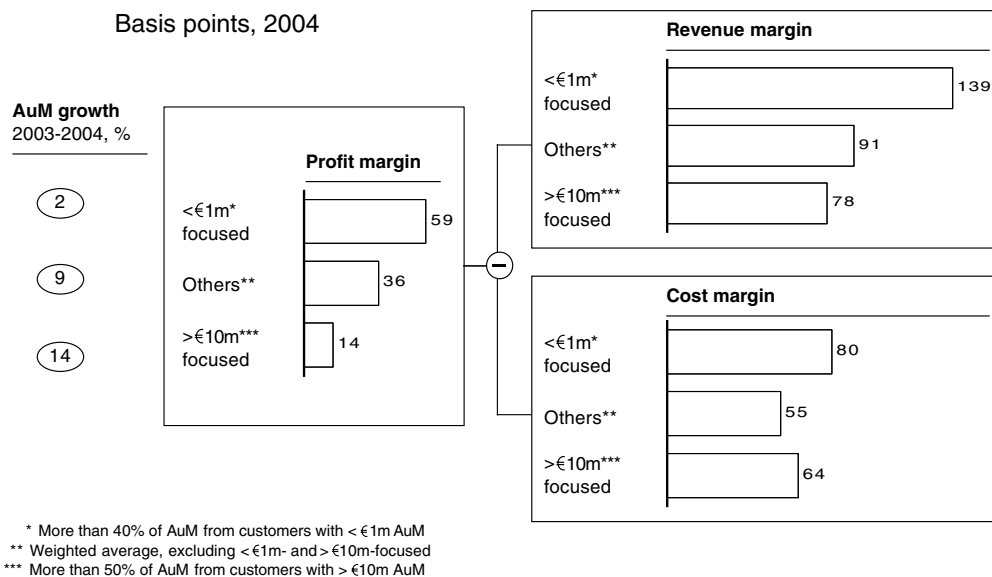
Source: Boston Consulting Group. Reproduced by permission.

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2005

**Figure 1.25** Economics of private banking versus brokerage

Source: UBS investor presentation; author's analysis.



* More than 40% of AuM from customers with < €1m AuM

** Weighted average, excluding <€1m- and >€10m-focused

*** More than 50% of AuM from customers with > €10m AuM

Figure 1.26 Economics of banks focussing on selected client wealth bands

Source: McKinsey European Private Banking Economics Survey 2005. Reproduced by permission.

propositions and operating models appropriately: one-size-fits-all wealth management approaches do not work. A related factor is the proportion of clients with wealth below the bank's stated account minimum, which is around 50% for many players.

- *Other factors*, including asset, product and mandate mix, sales productivity and operational efficiency, each of which is explored elsewhere in this book.

1.4 COMPETITIVE LANDSCAPE

Against this backdrop of historically strong growth and attractive economics, it is no surprise that the number and range of institutions providing wealth management services has been rising dramatically. A decade ago, wealth managers mostly cloaked themselves in secrecy; very few people knew the names of more than a handful of players. Today, the types of players calling themselves wealth managers is truly vast – everyone from one-man-band advisors to companies as large as Citigroup. It is difficult to name a single large bank that is *not* targeting the wealth management market.

Traditionally, the industry was dominated by private banks and stockbrokers. But there were important regional differences in the dominant types of player. To some extent, this reflected differences in the structure and regulation of the financial services industry as a whole. Broadly, there are two main models:

- *North American model*, where the industry is dominated by full-service and discount brokerages and money managers, whose strengths lie in the investment area, rather than in traditional deposit gathering. As noted above, the traditional emphasis here is on a (transaction-driven) commission-based business model.
- *European model*, where universal and traditional private banks dominate, due to their ability to offer a comprehensive range of wealth management products and services. The emphasis here is on a fee-based business model.

ILLUSTRATIVE

Breadth of offer

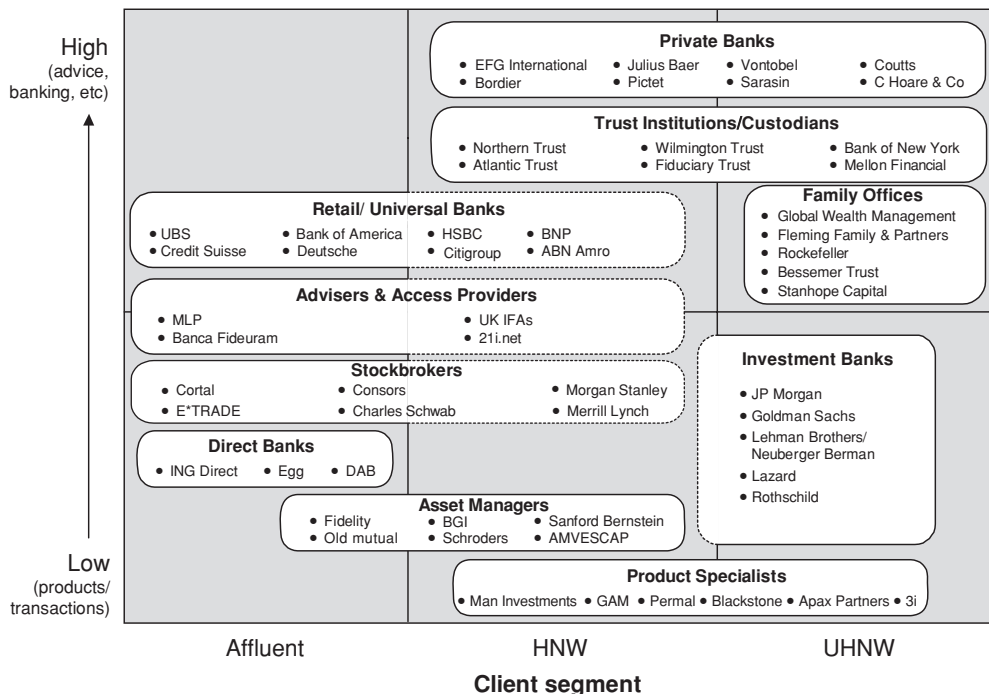


Figure 1.27 Wealth management competitor landscape

Source: Author's analysis.

The following provides a brief overview of the main types of wealth management players. There are huge differences among them in terms of the types of clients served and the types of products and services offered (see Figure 1.27). They also differ in terms of distribution channels, participation within the industry value chain, geographic coverage and scale. It is a complex patchwork. Chapter 6 provides more detail. The main types of player are:

- *Pure private banks* is a broad category of player that includes the classic Swiss private banking partnerships and other independent players. Mainly targeting HNWI, these institutions offer clients end-to-end capabilities via a relationship with a senior banker (the relationship manager) that is confidential and founded on trust. Typically, the relationship manager is the client's sole contact point and handles all aspects of the relationship. But private banks, though important, are by no means the only player in the wealth management industry. In fact, recent research by Scorpio Partnership shows that private banks manage only around \$4.6 trillion, or 16%, of global HNW wealth.
- *Trust banks* are essentially the US equivalent of the traditional European private bank. Most have their roots in providing trust and custody services, but have broadened their product range over the years. They now also provide asset management, insurance and financial, tax and estate planning. Their core target client segment is UHNWIs, but many have also developed tailored propositions for HNWI.
- *Retail and universal banks* target affluent clients who need comprehensive advice and who value a close banking relationship. Most of them have been shifting their focus up the wealth curve. They offer products across the full client balance sheet, but often struggle to integrate and coordinate them effectively. The emphasis is on 'farming' their existing customer base, including business banking clients. Examples include Citigroup, HSBC, Bank of America and ABN AMRO.
- *Family offices* serve the very wealthiest clients, acting as an integrated hub for the family's financial administration. They perform, essentially, three main functions: (a) specialist advice and planning (including financial, tax, strategic and philanthropic); (b) investment management (including asset allocation, risk management, investment due diligence and analysis, discretionary asset management and trading); and (c) administration (including coordination of relationships with financial services providers and consolidated financial reporting). From the client's point of view, the family office's key attractions include independence, control and highly tailored, specialist expertise. A family office may be dedicated either to a single family or serve a small number of families. Some of the major private banks, such as Pictet and JP Morgan, have developed their own multifamily offices, but the vast majority are independent specialists (and have, in some instances, evolved from single-family offices). Family offices are particularly well developed in the US, and are starting to evolve in Europe.
- *Financial advisors* focus on clients who seek independent investment advice. Their distribution traditionally relies heavily on a mobile sales force of well-trained and highly incentivised advisors. Over recent years, a number of web-based advisors have emerged. They offer above-average advisory quality and act as a gateway to third-party product providers.
- *Stockbrokers and wirehouses*¹⁸ target self-directed investors and traders for their day-to-day transaction execution and investment needs. They offer low-cost access to a range of investment products as well as to extensive investment research. But they are not exclusively dedicated to affluent clients, do not typically offer much in the way of customised advice and

¹⁸ US term for the largest brokerage houses.

often lack transaction banking products. It is a diverse group, including firms that have their roots in online broking such as E*TRADE, as well as full-service brokers such as Merrill Lynch.

- *Direct banks* are specialist, low-cost, remote-channel attackers. Although these models are targeted generally at self-directed clients and do not all focus exclusively on affluent clients, some have nevertheless been able to attract and retain significant numbers of mass affluent clients through aggressive pricing and product innovation and simplification. Examples include ING Direct, which now operates in nine countries, and Egg in the UK.
- *Asset managers* include independent money managers and divisions of financial services groups. They serve wealthy clients directly through their own captive sales forces, and act as product providers/packageers to third-party distributors seeking best-of-breed and specialist fund management expertise. Examples include Fidelity, Old Mutual and AMVESCAP.
- *Product specialists* include hedge funds, private equity funds, mutual funds and structured product providers. Lacking their own captive distribution channels, they manufacture products for distribution across a range of HNW channels, including private banks and financial advisors.
- *Investment banks*, such as Goldman Sachs and Lehman Brothers, are stretching their institutional capabilities and targeting it at UHNWIs and, increasingly, the HNW segment. That has been driven, in part, by investment banks' desire to reduce their dependence on volatile trading revenue. To UHNWIs, they offer exclusive access to sophisticated institutional-quality products, including co-investment opportunities. To HNW business owners, for example, they offer sophisticated wealth-diversification products, often as an extension of their corporate finance work. They are also able to leverage their product structuring capabilities (often white-labelling products for private banks) and can connect HNWIs to hedge funds via their prime-brokerage operations.
- There is also a range of *other players*, which include insurance companies, accountancy companies and attorneys. Insurance companies, such as Skandia, primarily target the mass-affluent client segment. In establishing distinct wealth management operations, they have been motivated by the desire to sell additional products to their existing client base, retain maturing life insurance assets and leverage their distribution networks. Accountants, solicitors and other professionals offer financial planning, trusts and fiduciary services, tax advice and specialist services; some also directly manage wealth themselves.

Amid the market turmoil of 2000–2002, private, retail and universal bank incumbents and family offices were arguably the most resilient. Retail and universal banks, in particular, have been able to leverage their large existing customer bases, given that they typically hold up to 90% of the primary bank deposits and up to 80% of the financial assets of all affluent customers.

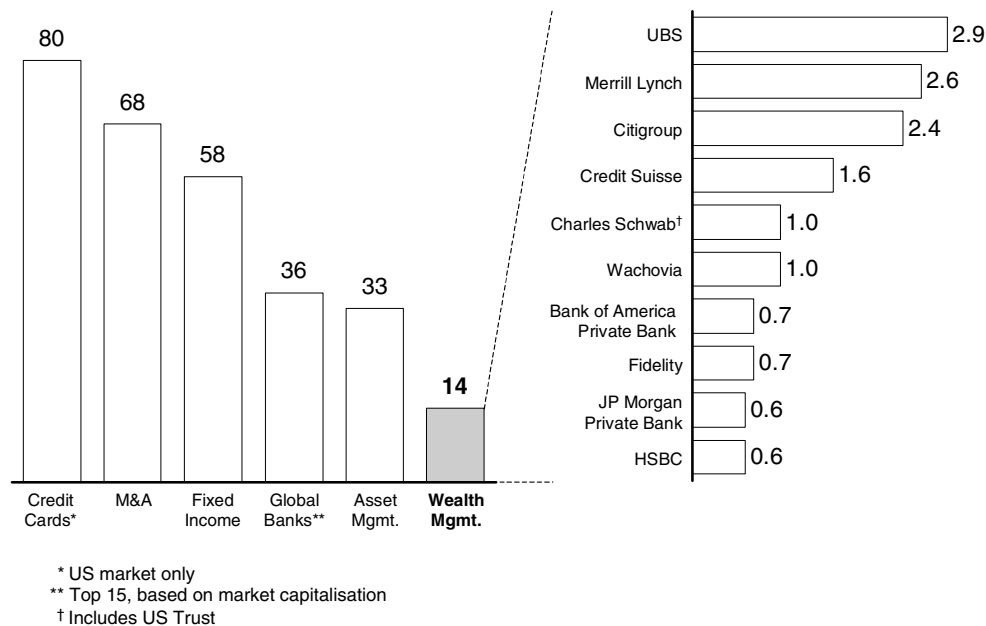
Financial advisors have made serious inroads, particularly in Europe, but their success has not been consistent across all geographies. In addition, wide differences exist among players following the same broad model. For example, some, such as MLP in Germany, have been able to increase their client base significantly, while others, such as some of the Italian promotori networks, have recently seen a slight fall in client numbers as competition has intensified.

1.4.1 Industry concentration

A consistent feature of the industry's competitive landscape is its high level of fragmentation. Deriving estimates of market share is tricky, driven by issues such as what constitutes wealth management, what types of asset to include (i.e. whether, in addition to AuM, assets under

Global market share of top 10 players, end 2004

Percent

**Figure 1.28** Wealth management industry fragmentation

Source: Mercer Oliver Wyman; Bloomberg; Global Investor; Deutsche Bank; Datastream; Barron's; Wealth Partnership Review; Datamonitor; Scorpio Partnership; company data; author's analysis.

custody or in transaction accounts should be included), how to strip out non-HNW (and, in some cases, institutional) assets, data availability, etc. In the following, we define market share by AuM, and have used Capgemini/Merrill Lynch data as our estimate of the total market size. We have tried to focus, where possible, only on fee-based assets owned by HNWI's. The analysis should, however, be regarded as indicative of the relative size of key players. Outside the top 20, the degree of accuracy is lower, given the limited disclosure, particularly by some of the privately held players.

In 2004, the market share of the top 10 wealth managers was 14% and that of the top 20 was less than 20%. Wealth management is therefore one of the most fragmented sectors of the financial services industry (see Figure 1.28). With the possible exception of UBS and perhaps Citigroup, HSBC and Merrill Lynch, there are no truly globally dominant players. Seven of the top 10 players are based in the United States. The largest wealth manager in the world, UBS, had wealth management AuM of \$878 billion at end 2004, which is equivalent to less than 3% of global HNWI wealth. Outside the largest players, there is a huge number of niche players in each regional market.

The fragmented nature of the market is somewhat counterintuitive given the difficulties the industry has faced in recent years, which ought to have led naturally to consolidation. Though there has been recent merger and acquisition activity within the industry, it has largely been limited to players below the top 20 threshold, with similar cultures and/or complementary client bases. As noted in Chapter 9, UBS is one key exception, having made a series of bolt-on acquisitions, i.e. small acquisitions that fit culturally and strategically, without hampering cash generation. Overall, the market share of the top 10 players has remained remarkably stable in recent years.