Global Private Banking and Wealth Management

The New Realities

David Maude

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To Francesca and Antonio

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Preface

"Let me tell you about the very rich" (with undisguised envy). *"They're very different from you and me."*

F. Scott Fitzgerald

"Yes" (taking a long pull from a thick Havana and pausing longer for dramatic effect). *"They have more money."*[1]

Ernest Hemingway

It is easy to forget that only a few years ago, wealth management was the darling of the financial services industry. Highly profitable and growing rapidly, everyone wanted a piece of the action. Indeed, come 1999, it was difficult to find a bank of any stripe that was *not* targeting the wealth management business.

Driven by strong global economic growth and buoyant financial markets during the go-go years of the 1980s and 1990s, wealth managers were able to prosper simply by showing up, being there and standing relatively still. There was no great need to have a clear strategy or distinctive client proposition. In many cases, the assets – and profits – just flowed in.

So, what happened? The financial market turmoil of 2000–2002 left many wealth managers – old and new – highly exposed: exposed more than ever to the global equity market; and, in the case of the large number of integrated players, exposed, too, to accusations of inherent conflicts of interest. As Warren Buffet famously said, "It's only when the tide goes out that you learn who's been swimming naked."[2] In short, for many players, at least for a while, wealth management lost its golden lustre.

Today, with the recovery in financial markets, many players are refocusing on wealth management, and growth initiatives are firmly back on management agendas. The industry's profile has never been higher (see Figure 0.1).

Going forward, however, financial markets alone cannot be relied on to grow or even sustain profits. Many wealth managers' strategies are in flux and the pace of change is picking up. New initiatives are appearing by the week.

The main aim of this book is to help wealth management players chart a course through the new, increasingly choppy, waters. I aim to provide a flavour of the key issues at stake,

[1] Conversation anecdotally reported to have taken place in a Paris café in the 1920s. In fact, Fitzgerald wrote the first phrases in a 1926 short story, 'The Rich Boy', and Hemingway replied a decade later in an article, 'The Snows of Kilimanjaro', published in *Esquire*. (And Hemingway's glib retort was borrowed from Mary Colum, an Irish literary critic.)

[2] Source: Berkshire Hathaway Inc., Chairman's Letter to Shareholders, 1992.

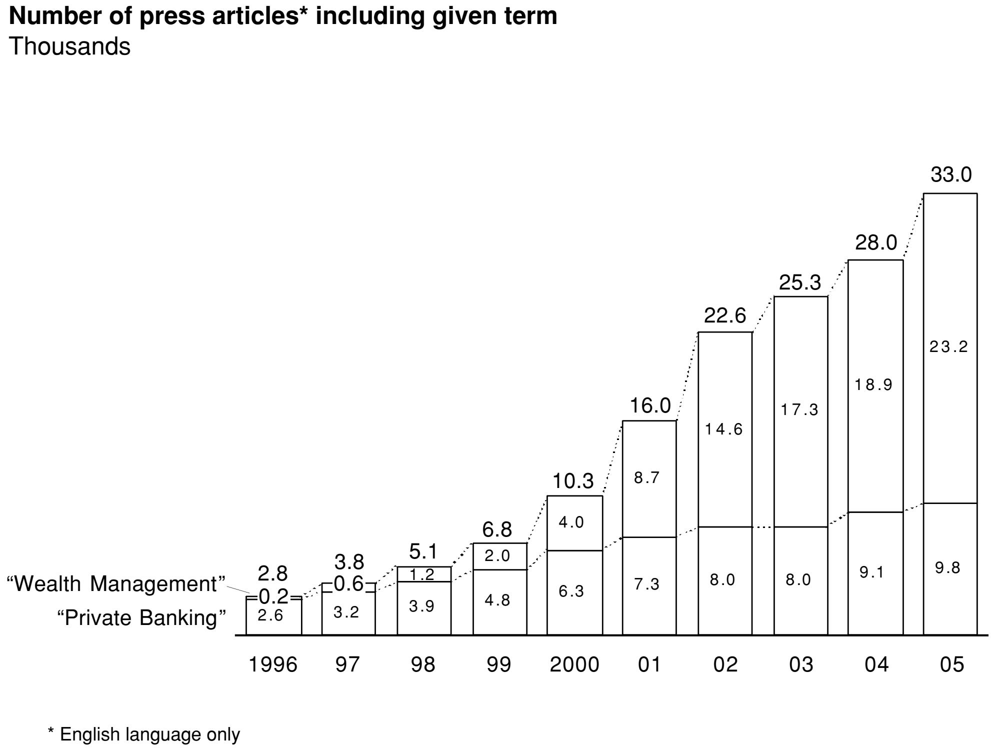

Figure 0.1 The rise and rise of wealth management
Source: Factiva; author's analysis.

but the book certainly does not attempt to cover every possible aspect of wealth management. Along route, I hope to blow away some of the myths that have grown up around the industry.

The good news is that, looking ahead, the industry's intrinsic fundamentals are relatively solid. There are still fortunes to be made in wealth management. But one thing is clear: the private banking and wealth management business will not get any easier to manage.

David Maude
Verona, May 2006
david_maude@lycos.co.uk

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Needless to say, any errors in the text are mine alone.

DJM

1
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 seventeeth 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.

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*

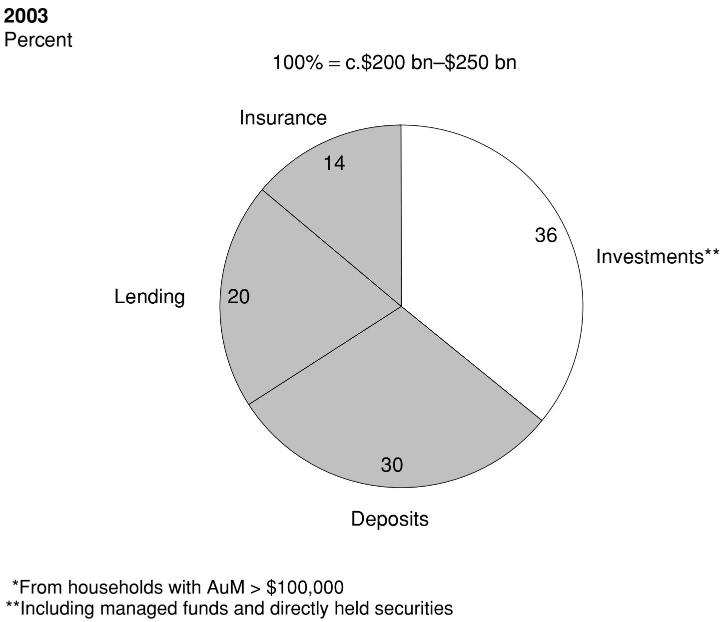


Figure 1.1 Wealth management revenue pool* by product
Source: Boston Consulting Group; author's calculations.

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

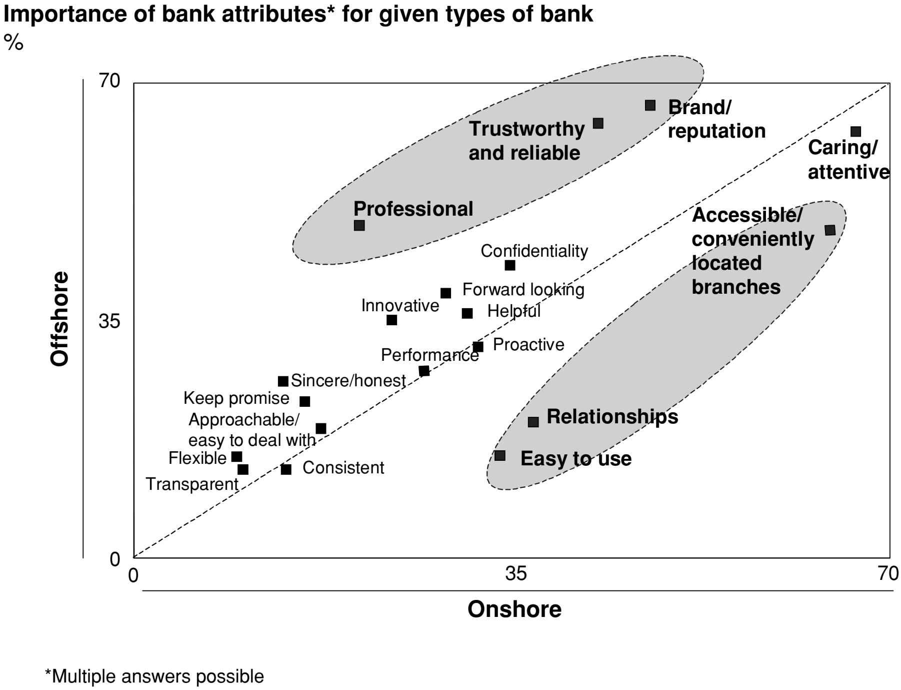


Figure 1.2 Wealth manager attributes
Source: McKinsey & Company, 'Annual Investment and Wealth Management CEO Conference, 2005'. Reproduced by permission.

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

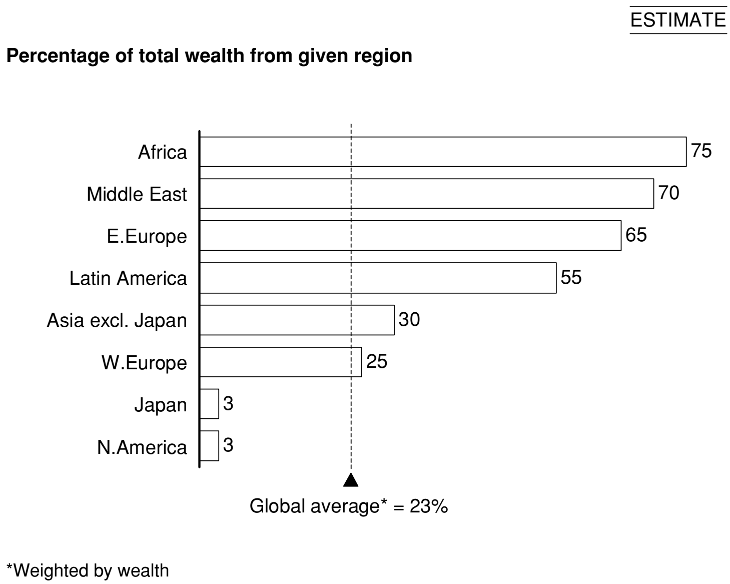


Figure 1.3 Wealth held offshore
Source: Boston Consulting Group; Julius Baer; author's client work.

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.

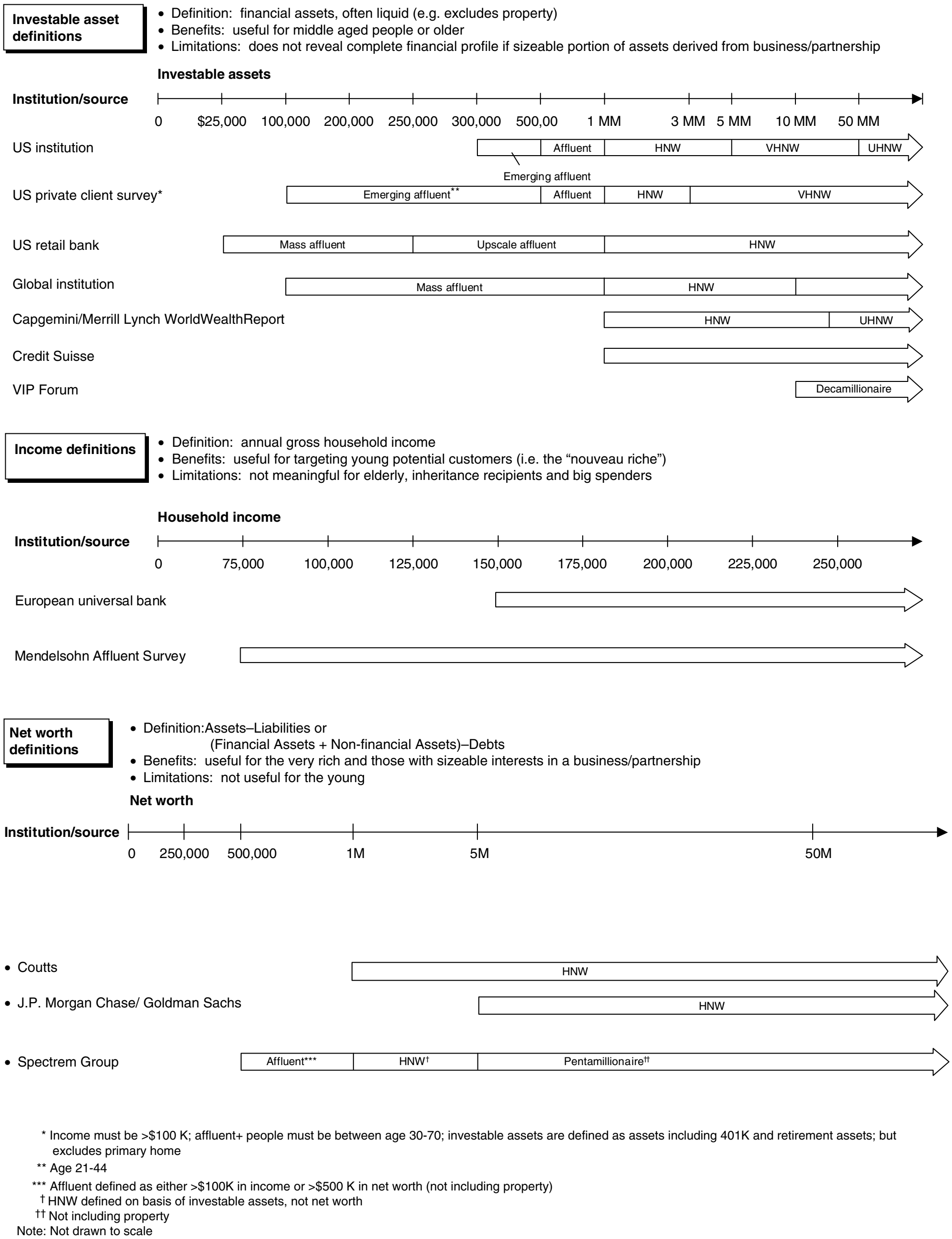


Figure 1.4 What is wealthy? Client indicative wealth threshold definitions
Source: Author's analysis.

EXAMPLES OF DIFFERENT ENTRY CRITERIA APPLIED BY PRIVATE BANKS

Example 1	• Minimum account size USD 1m
Example 2	• USD 5m+of bankable assets
Example 3	• Minimum account size USD 0.5m **or** • Use of derivative products **or** • Use of discretionary mandate **or** • Language requirements
Example 4	• Decision of relationship manager based on assessment of client's financial potential
Example 5	• 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 estimate[4] 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, HNWIs 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.

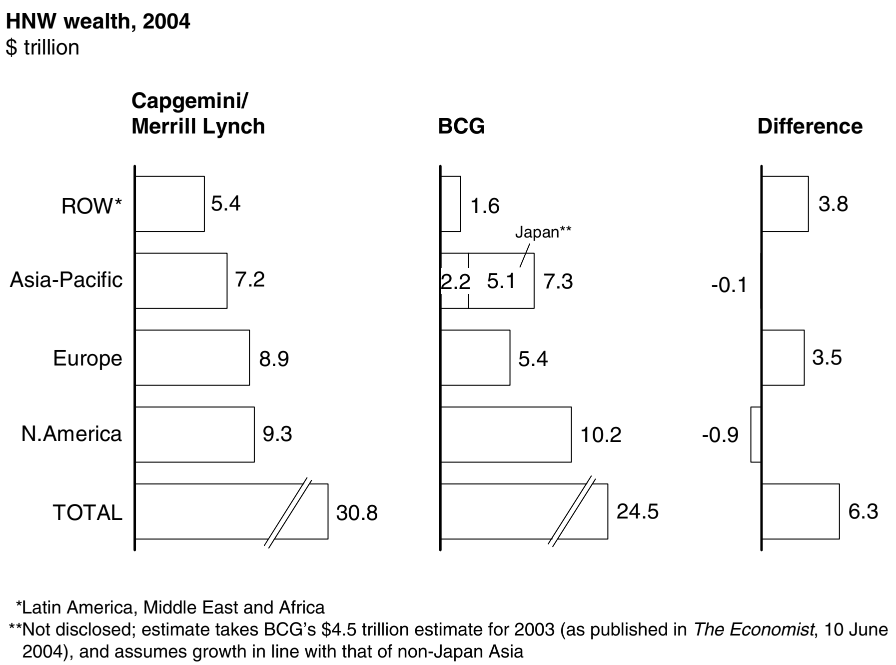


Figure 1.5 HNW wealth estimate comparison
Source: Capgemini/Merrill Lynch; Boston Consulting Group; *The Economist*; author's calculations.

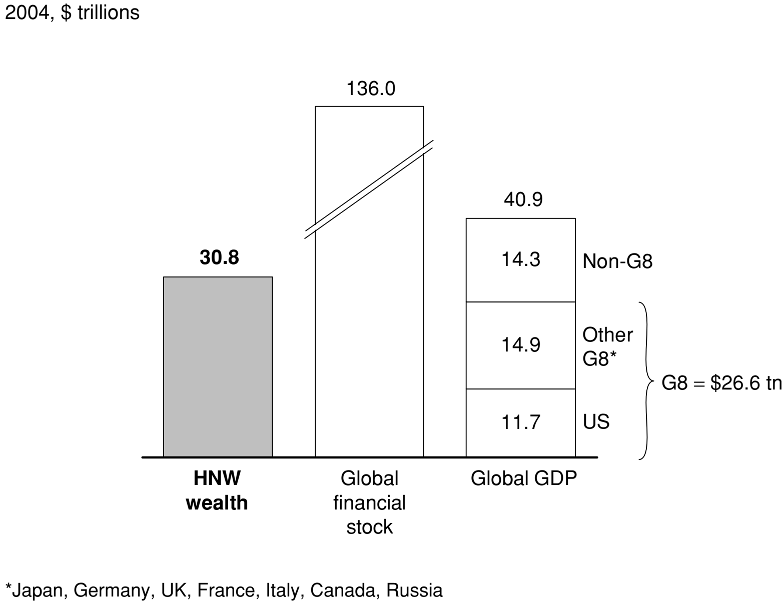


Figure 1.6 Global HNW wealth in context
Source: Capgemini/Merrill Lynch; IMF; McKinsey Global Institute.

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

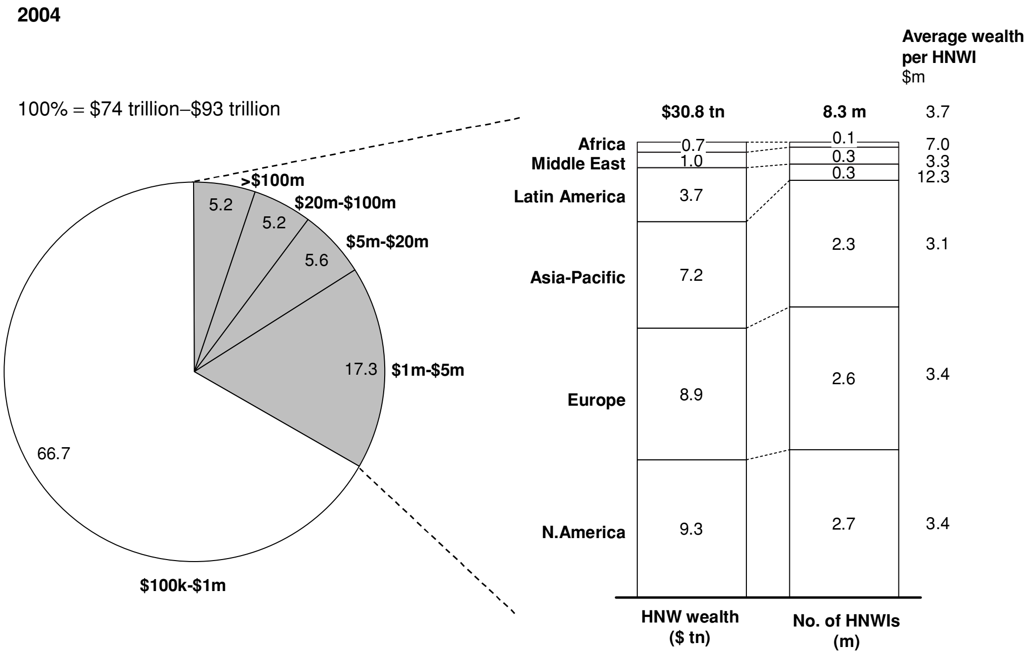


Figure 1.7 Global wealth by region and client wealth band
Source: Boston Consulting Group: Capgemini/Merrill Lynch; author's calculations.

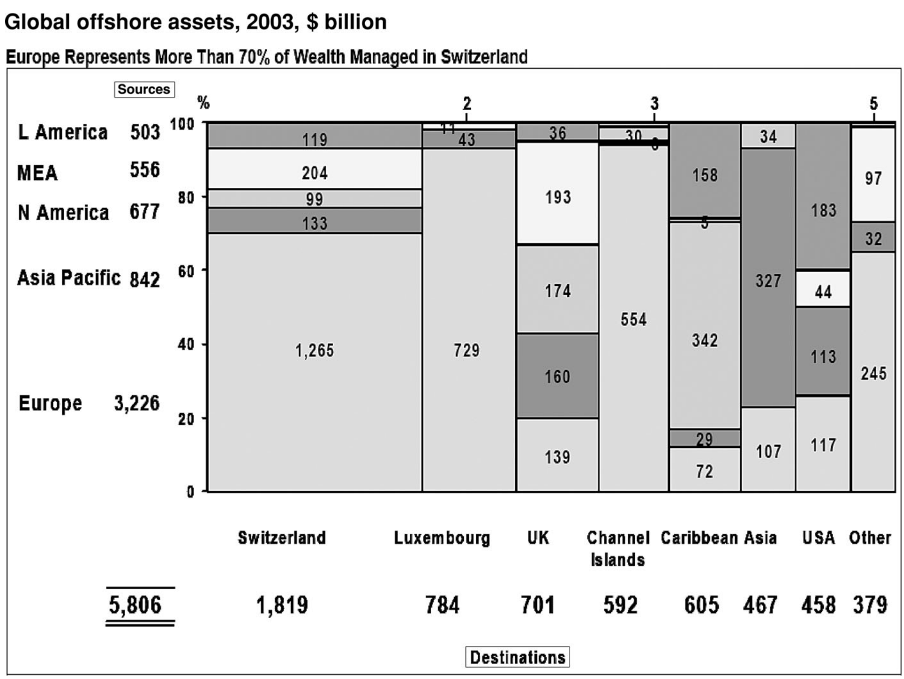


Figure 1.8 Offshore wealth: sources and destinations
Source: Boston Consulting Group; Huw van Steenis, Morgan Stanley. Reproduced by permission.

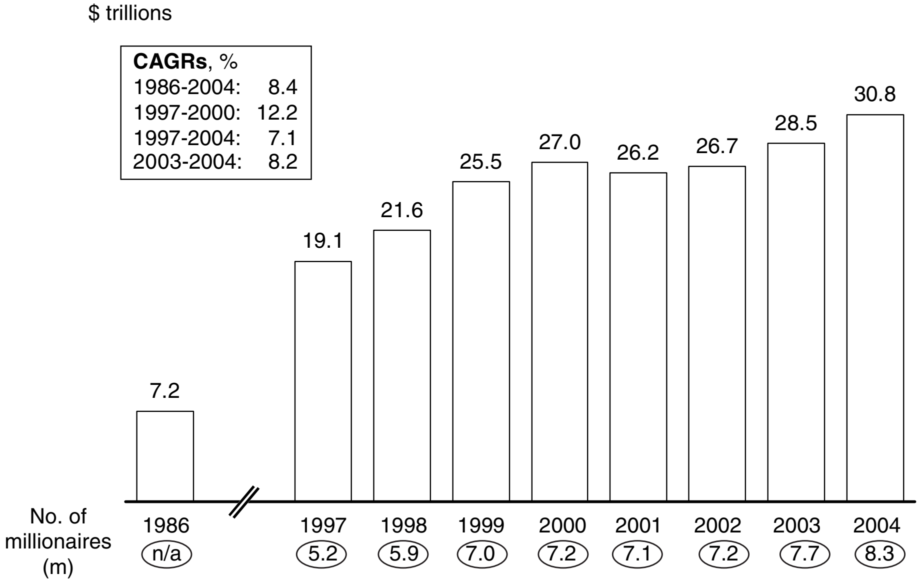


Figure 1.9 Growth in global HNW wealth
Source: Capgemini/Merrill Lynch 'World Wealth Report' (various years); author's calculations.

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.

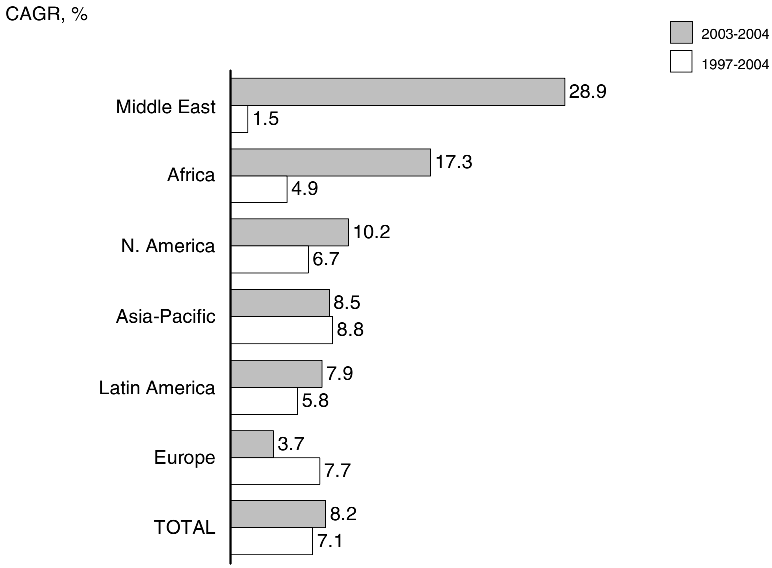


Figure 1.10 Growth in HNW wealth by region
Source: Capgemini/Merrill Lynch 'World Wealth Report' (various years); author's analysis.

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.

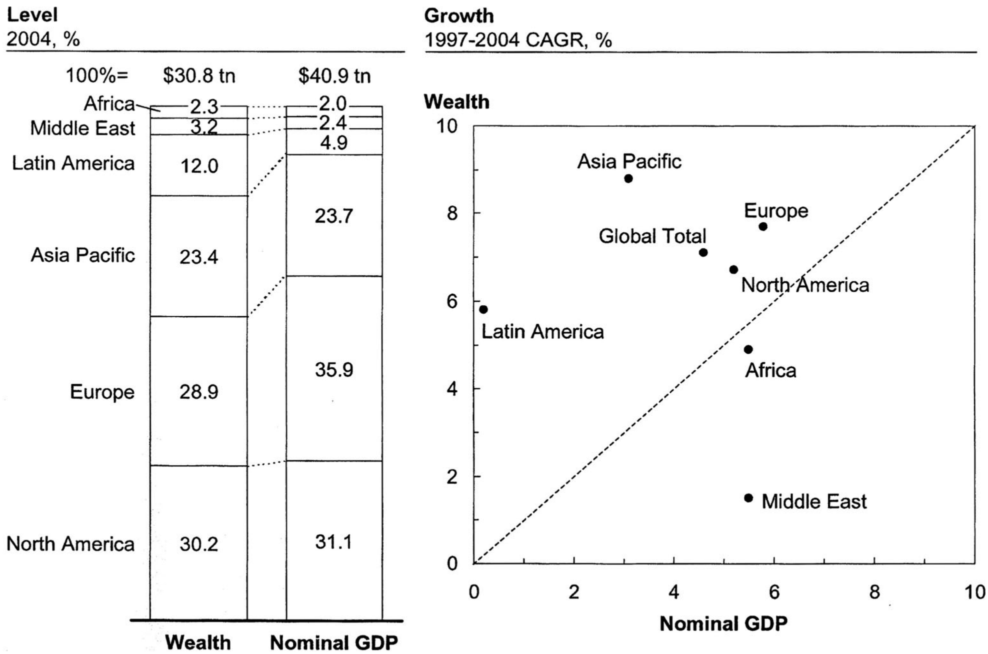


Figure 1.11 Relationship between wealth and nominal GDP
Source: Capgemini/Merrill Lynch; IMF; author's analysis.

1.2.1.2 Asset prices

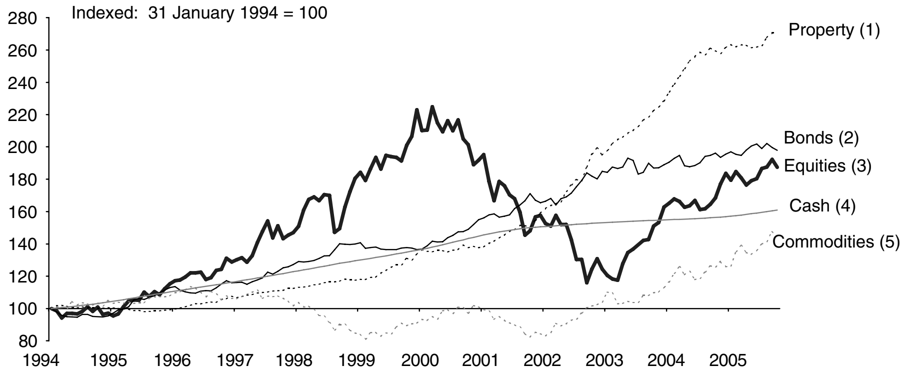
The 1990s surge in wealth was largely due to the biggest ever bull market in equities, particularly in America. Some of the increase in investable wealth reflects a shift of assets to the market that had previously existed in an illiquid and less measurable form. In recent years, many family-owned companies have been sold, including a growing number through an initial public offering (IPO). To some extent, this merely represents wealth reclassification rather than genuine new wealth creation.

Figure 1.12 illustrates how, despite the equity market downturn from 2000 to 2003, other assets, notably property and commodities, have, to some extent, taken up the slack, and fuelled huge interest in product innovation and asset class diversification.

1.2.1.3 Wealth allocation

Another recent trend has been the increasing income and wealth *concentration* among the more affluent segments of society as a whole. Going forward, BCG expects that the wealth of the world's wealthiest investors (i.e. those with more than $5 million) will grow by 6.6% a year between 2004 and 2009, while that of the least wealthy (i.e. those with less than $100 000) will shrink by 0.3% a year.

Nowhere has this trend been greater than in the US (see Box 1.2). For income, the share going to the top 1% was 15% in 2002 according to a study of tax returns by Thomas Piketty and Emmanuel Saez (2004). That compares to around 13% in the UK and Canada, but compares



Notes:
1. UK residential property; Halifax house price index
2. Based on US Treasury bonds
3. Based on world equity market index of Morgan Stanley Capital International
4. US Fed funds rate
5. Based on Reuters–CRB index

Figure 1.12 Selected asset prices
Source: Author's analysis.

Box 1.2 US Wealth Dynamics[6]

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

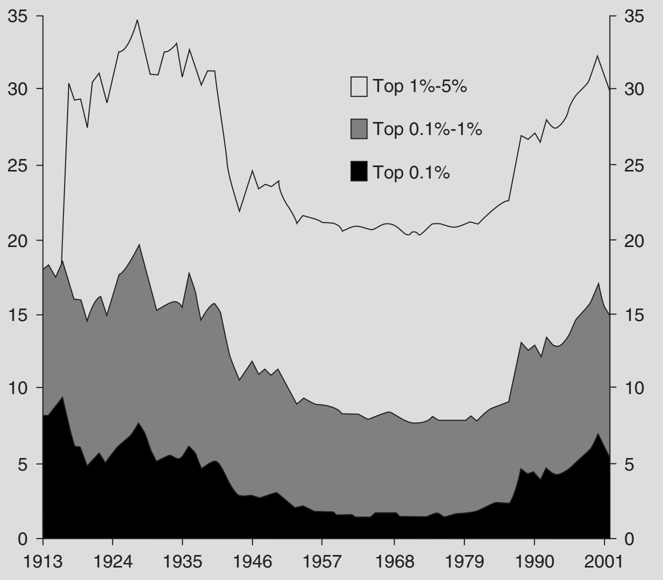


Figure 1.13 Income shares of highest US earners, percent
Source: Picketty and Saez (2004).

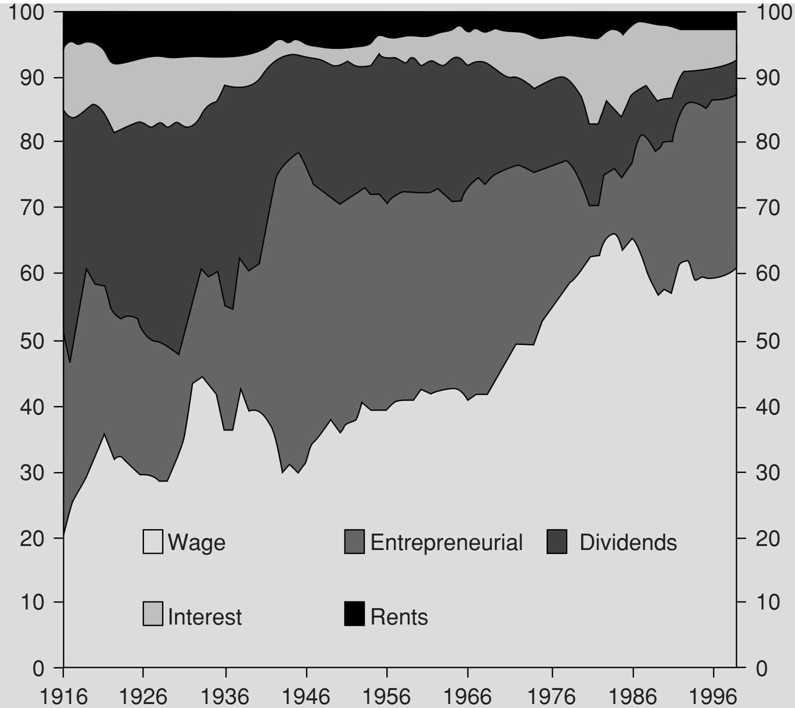


Figure 1.14 Sources of income, top 1% of earners, percent
Source: Citigroup Global Markets (2005), based on Piketty and Saez (2004).

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 pursuade 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 billionairess 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 trillion[9] 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'.