

Getting the value proposition right for the next phase of the wealth management service model

Presentation of key findings

Zurich/Munich, March 2, 2009

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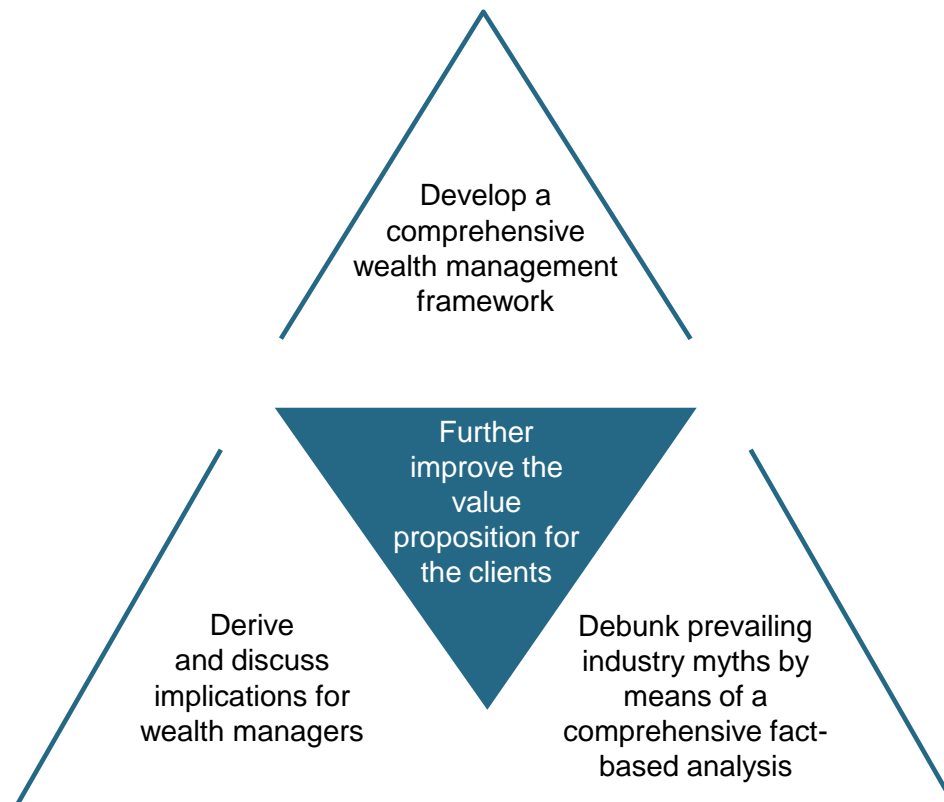
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Aim of the Roland Berger study is to clarify long-lasting myths in the wealth management industry

Aim of the study



Sources

- Detailed interviews and discussions with 30 **international senior experts** and 25 **experts from Roland Berger Strategy Consultants**
- **Expertise** of Roland Berger Strategy Consultants gained from numerous projects (e.g. insights from a survey among 1,800 wealth management clients in Switzerland)
- **Survey** of 177 clients and 133 relationship managers from Europe and Asia from August 2008 till January 2009

The study looks at the industry from different perspectives – Upon that we derive value adding conclusions

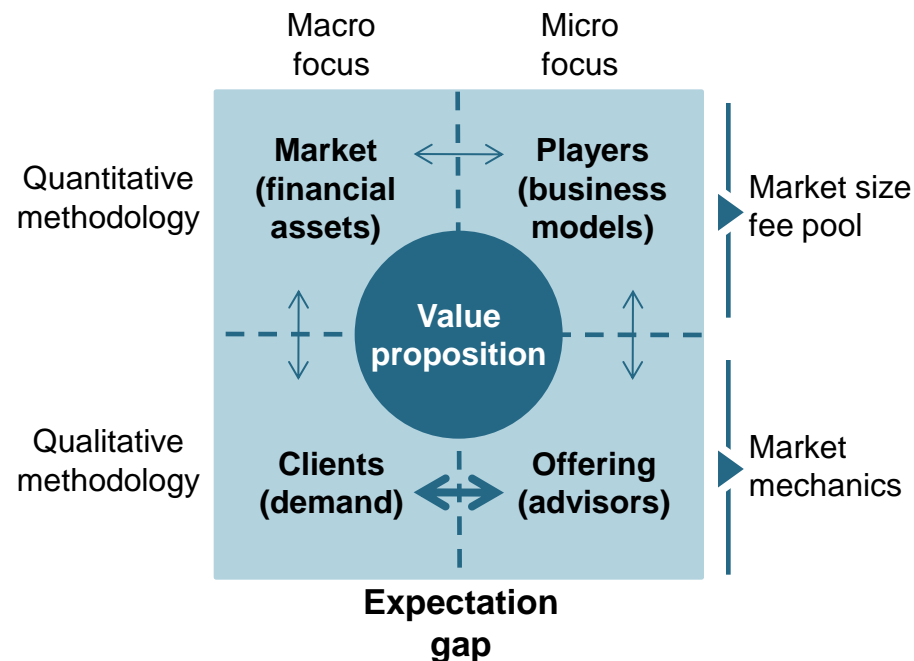
Structure of the study

Market

- Volume of bankable assets
- Onshore and offshore assets
- Legal, regulatory and economic framework

Clients

- Client issues
- Client needs and expectations



Players

- Business models of wealth managers
- Success factors
- Drivers

Offering

- Client advisors' perspective on products/offerings
- Banks' perspective on products

Value proposition

- Profitability of wealth managers
- True value proposition for wealth managers

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Areas for improvement

The way out: regain trust, reduce complexity, becoming more efficient, and build a true client centric organization

- **Trust Crisis:** What started with the burst of a credit bubble in the US has affected almost all asset classes globally with the enormous leverage in the financial system and accounting rules acting as a very efficient transformation mechanism. Besides all these technicalities it is the loss of trust on all levels which resulted in bankable assets, the ones relevant for estimating the wealth management market, to have collapsed *by about 20% to €24.3 trillion* within one year.
- **Profitability under pressure:** Our calculations show, that profitability is materially under pressure based on the combination of the reduced FuM and materially *lower revenue margins* on the back of client reactions (shifting out of higher margin, complex products, continued de-leveraging, etc). This drop in revenues only partially can be countered by drastic cost reductions.
- **Offshore Banking is not dead:** There are a lot of *very legitimate reasons* for clients wanting to have their assets managed abroad, not just tax considerations. Besides issues around political stability, quality of service, etc in the country of residence, stronger tendencies towards a transparent citizen will continue to support the true need for (financial) privacy.
- **Expectation gap widened:** The financial crisis has made shortfalls in the technical "Know Your Client" driven advisory process apparent. Those Wealth Managers which are *about to re-center their activities around their core assets, i.e. the clients*, are very likely to be materially better off than those just hoping that the markets will recover some day.
- **Sitting through the crisis does not seem to be an option**

Besides some cyclical impacts, this crisis is likely to call for substantial structural changes for the wealth management industry

Initial situation

- Wealth management was an **attractive segment** for incumbent and new players
- **Strong economic growth** offers **new possibilities**, especially in Asia
- **Focus on growth** despite **higher volatility** and increasing discrepancies
- **Blind trust** in the industry partially driven by inconsistent regulation (e.g. funds versus structured products, funds versus hedge funds)
- Opening of **new markets, new asset classes**, and creative development of **new investment forms and products**
- **Offshore business** did **not** traditionally look at the different reasons for investing abroad; treated as something of a black box

Long standing myths

Myth #1: The wealth management market is large with strong growth and room for new players

Myth #2: The growth of the market is primarily driven by countries with strong economic growth

Reality

- The size of the market for wealth management is generally overestimated (based on bankable assets)
- It is currently shrinking and highly fragmented
- Many new clients in the upper wealth bracket do indeed come from these countries
- However, a greater share of wealth comes from investors in developed economies
- The aging population in developed economies offers more potential and should not be neglected

The size of the wealth management market and the current revenue potential have declined substantially

What has changed so far?

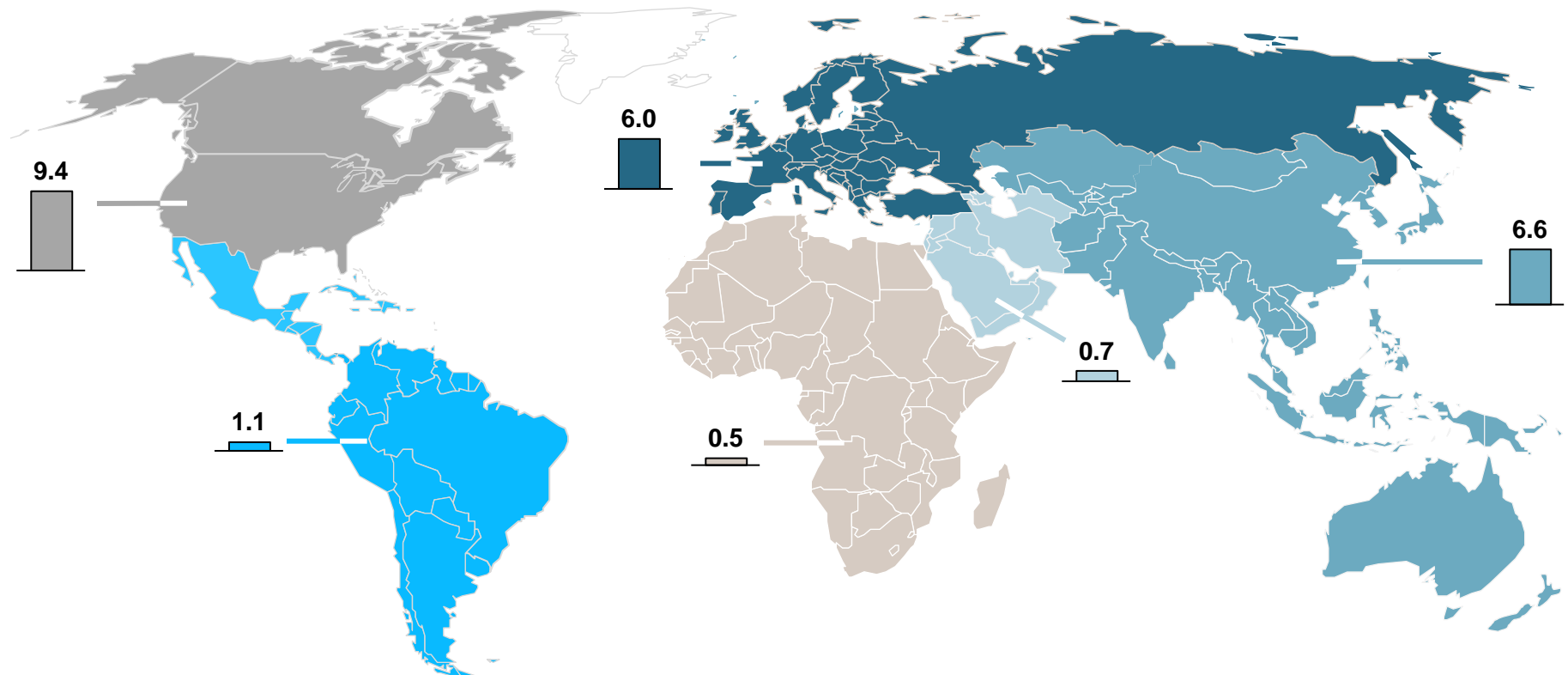
- Asset base and financial **wealth** have been substantially **fallen** (funds under management have shrunk by around 20%, i.e. EU 6 trillion)
- Uncertainty has led to **great volatility** in all asset classes – historically stable correlations have changed sharply
- Almost **all asset classes** and regions have been **affected**, albeit to different degrees
- Distortions are caused by **partial regulation** and **incorrect incentives**
- **Trust** in the industry **has suffered**

What will come next?

- Potential **long-term effects** on the whole economy are already visible from the impact of the real economy
- Pressure to **increase regulation**
- Initiatives to **align regulation** internationally (e.g. G20, OECD, other bodies) and introduce a principle of "same business, same risk, same regulation"
- Increasing **pressure on non-declared offshore business** with regard to tax enforcement. **Amnesties** will play a **major role** – EU-interest taxation might be enlarged in scope
- **Trust building measures** through communication and action are required

Our research shows that the total financial assets held by individual investors are worth EUR 24.3 trillion

Global distribution of financial assets held by individuals by domicile [2008, EUR trillion]



Strong past performance and healthy future prospects led to a shift in risk profile and perceived risk capacity

Initial situation

- Wealth management clients are typically **older** – banking assets are only a fraction of their wealth and they have **multiple banking relations**
- **Wealth has various origins** – inheritance, the sale of assets and pension provisions are commonest
- **Clients' motivation** for buying wealth management services **varies**
 - Some clients wish to enhance their financial options by receiving expert advice and entrusting their assets to professionals
 - Other clients focus on **quality of service**; they have little price sensitivity
- **Price sensitivity is generally low** – there is great variation based on current overall performance, clients' asset volumes and non-declared offshore money

Long standing myths

Myth #3: The most important target client for wealth management is the young and dynamic entrepreneur

Myth #4: As clients become more educated and have instant access to financial information, they become more critical and independent

Myth #5: Wealth management clients make rational decisions and are cost-conscious and performance-oriented

Reality

- Many wealth managers in fact focus on different segments
- Entrepreneurs' assets are often tied up with their companies
- More traditional segments, such as long-term savers or people inheriting wealth, can be much more attractive
- As market complexity and product sophistication increases, clients are finding it harder and harder to keep up
- Clients are not becoming more self-directed and independent
- This is leading to greater demand for professional advice from more critical clients
- Our research does not indicate that high margins are a reason for clients to switch to alternative investments such as ETFs
- As long as clients receive high-quality advice they are willing to pay high prices

Clients are now looking for a general review of their investments with an eye to transparency and risk-adjusted performance

What has changed so far?

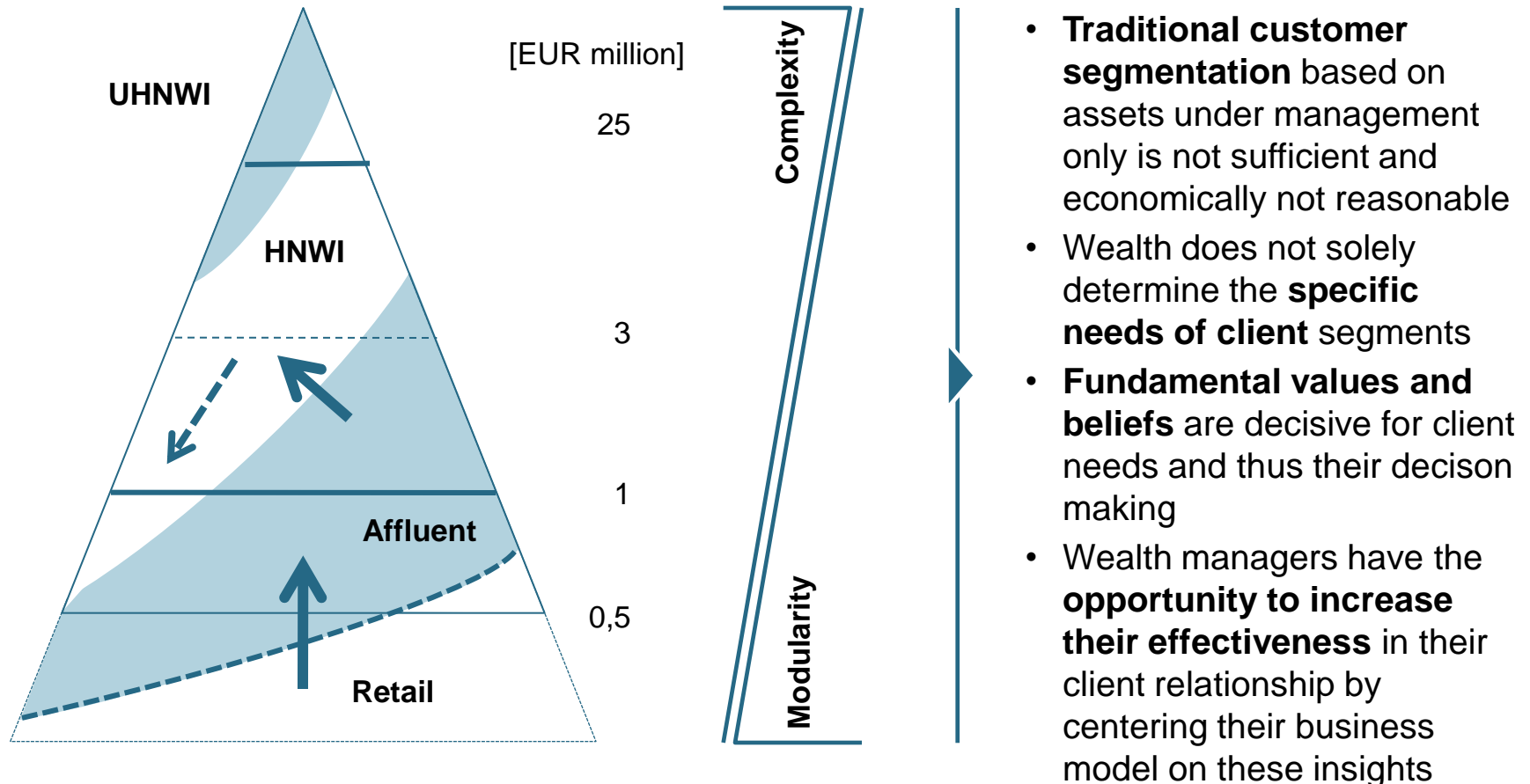
- Mixed signals and controversial information on future market developments have led to **confusion**
- Private clients have **lost confidence** in the industry and no longer **trust** their personal advisors like they used to
- There is a **flight to cash** and resistance to trade – clients have **exited asset classes** such as absolute return funds and structured products
- **The expectation gap has widened.** Price sensitivity has increased as clients have become dissatisfied with performance; at the same time, the complexity of products means that clients have difficulty assessing their price

What will come next?

- Clients are likely to **remain critical** for some time yet, asking difficult questions and demanding clear explanations
- Clients value advisors who take the time to talk to them and appear to **understand them** and their needs. **Trusted advisors** have the ability to manage client expectations in the interest of the client as the **key for client satisfaction**
- Clients want to **review** their **risk situation** and define investment goals; they are asking for **products and solutions that they understand** – a call for simplicity and fitting solutions
- Clients will **return to normal, long-term asset allocation** (stocks, commodities, private equity and hedge funds) **as soon as markets regain momentum; reducing the complexity** of the offering is the key

Traditional customer segmentation approaches are not sufficient to create homogenous customer groups

Client segmentation based on core values



The industry's focus was on growth and product sales, with little pressure on efficiency and profit margins

Initial situation

- The market was solid, growing and offered a **broad range of opportunities**, making it highly attractive for both incumbents and new players. As a result, **no focus on efficiency** was necessary
- Saturation in home markets was more than compensated by new **opportunities in Asia** and other growth areas
- The war for talent was a key driver, leading to high compensation levels
- The focus was on client advisors who had strong **sales skills** and could transmit the "private banking ethos" to their clients
- Many large players focused on **pushing products**; clients were uncritical
- Only few wealth managers focus on a holistic offering, as it was mostly not required and demanding for the advisor

Long standing myths

Myth #6: Offshore business will finally disappear as tax loopholes are closed and international pressure grows

Myth #7: Leveraging economies of scale is key to profitability

Myth #8: Research capabilities and asset management know-how are a key competitive advantage

Myth #9: A group's internal investment bank creates significant benefits for the wealth management unit

Reality

- Non-compliant offshore business will indeed decrease in share
- Nevertheless efforts to undermine financial privacy will drive growth
- Other factors are the lack of trust in governments, political instability and booking center diversification
- Profitability does not depend on total assets under management, profitability is driven by asset mix and regional disparities
- The increasing complexity of business models will outweigh most scale benefits
- Collaborating with general asset management brings limited benefits
- Providing exclusive, sophisticated investment ideas and solutions is the only differentiation factor in the market
- Collaborating with a group's internal investment bank leads to limited revenue for the wealth management unit - it is the investment bank that profits
- The major benefits for wealth managers come from product innovation

After the crisis, wealth managers need to cope with lower returns and increasing costs also due to tightening regulation

What has changed so far?

- **Strong reduction of the top-line** due to the lower asset base, less trading income and changed product mix
- Many **value propositions** focusing on security, and active management have not delivered on their promises
- **Lack of communication** (what is going on and what went wrong) **fueled the loss of trust**
- General uncertainty in the market leading to increased **difficulties to judge the stability** of other players and partners – Increasing need for signalling and reputation
- **Reshuffling of wealth management units** away from troubled entities and low valuation of wealth managers allow for buying opportunities
- The **effect on offshore clients is twofold**: Reduction in non-declared money and/or increase in declared money

What will come next?

- **Legal actions and new regulation** will increase cost levels
- Increased **capital requirements** may lead to a deleveraging of the business: less risk but lower overall margins
- Continued **pressure on compensation structures** by public
- Need to **adapt processes, structures and spending behavior**
- Additional **entry barriers** for non-accredited players can reduce some pressure on margin
- Business models will have to be reviewed depending on a wealth manager's situation (integrated versus specialized model)
- Ongoing **discussion** on the role of **asset management and investment banking** for a wealth manager

Offering strongly based on a trusted relationship with strong focus on growing the assets – Risks considerations secondary

Initial situation

- Clients **delegate financial decisions** broadly on a **trust-based relationship**
- **Neither critical questions** regarding the content of their portfolios nor the fit with their investment framework/risk situation were addressed by clients
- Only few, large players have developed a comprehensive advisory process and **rely fully on the client advisor**
- Even products with a focus on capital protection (absolute return funds, some structured products) were working on the **assumption of steadily growing asset prices** and were only designed to offset small, temporary downturns

Land standing myths

Myth #10: Clients want to choose from a broad range of asset classes and investment products to benefit from new market opportunities

Myth #11: Pricing is still not very relevant in the wealth management industry. New pricing will compensate for lost margins

Myth #12: Clients want individualized solutions, and this is the key value proposition of wealth management

Myth #13: As clients' asset volumes grow, they demand more sophisticated solutions

Reality

- Only specific client sub-segments actively seek new investment opportunities
- Most clients (and their advisors too) cannot cope with the complexity of new offerings
- Strict pre-selection of products by client profile is important
- Client sensitivity towards pricing is low as long as net performance is positive
- Pricing becomes more relevant for clients as markets get more difficult depending on client profiles
- The industry should think of ways to base pricing on the value added provided to clients
- Clients want personalized service and solutions suited to their particular needs
- Solutions can be based on limited number of modular and flexible elements without impeding personal service
- The core need for sophisticated products is directly linked to clients' financial complexity
- However, many clients neither understand nor need complex products
- Additional need for sophisticated products is driven by client profile requiring careful advice

Significant losses and the unveiling of severe flaws in the offering request a broad rethinking of the value proposition

What has changed so far?

- Shift from **performance to risk consideration** – Risk needs to be taken into account actively by the wealth manager
- Absolute return products were not designed for large downside movements – Product category needs to be reconsidered as such
- Reduced share of wallet due to asset splitting/**diversification of bank relations** reduces client profitability and increases comparability of services (quality or price pressure)
- **Cash investments** with low margin – Lock-in in cash positions; difficult perception of value added
- Resilience to trade as well as the shift in product and asset mix both lead to **lower turnover/churn** in portfolio and reduced ticket income

What will come next?

- Critical view requires **review of value-added** provided to clients
- **Suitability of the offering** (products and solutions) becomes key success factor in client servicing
- Need to better **understand the client** and his needs – **Review of advisory process** with stronger involvement of **qualified specialists** such as financial planners, tax experts to provide adequate solutions
- Need to **review** and adapt **product offering** (complexity, pre-selected products) as many products were too complicated
- Need to **provide "secure" investment instruments**

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Wealth manager profitability seriously hit – Revenue losses might only be countered partially by drastic cost cuts

Asset class	2003	Gross margin	2007	Gross margin	2009e	Gross margin
Accounts, money markets, fiduciaries	16%	20 bp	12%	20 bp	18%	20 bp
Alternative assets ¹⁾	5%	180 bp	15%	190 bp	7%	180 bp
Third-party funds	8%	90 bp	6%	90 bp	8%	90 bp
Bonds	23%	50 bp	18%	50 bp	21%	50 bp
Equities	29%	100 bp	27%	110 bp	25%	100 bp
Investments financed by loans	4%	100 bp	8%	100 bp	6%	100 bp
Own funds	15%	150 bp	14%	150 bp	15%	150 bp
Total	100%		100%		100%	
Blended gross margin		86 bp		104 bp		88 bp

Change in pre-tax margin depending on reduction in costs

Cost reduction	0%	-10%	-20%	-30%	-40%	-50%
Change in pre-tax spread	-57.0%	-44.5%	-32.0%	-19.5%	-7.0%	5.5%
Change in pre-tax profit	-65.6%	-55.6%	-45.6%	-35.6%	-25.6%	-15.6%

- **Gross margin** is expected to be reduced to 88 bp in 2009
- Due to the reduction of assets under management and the reduction in the gross margin the industry faces **severe challenges**
- Hefty cost reductions still result in a **pre-tax margin decline**
- Companies need to focus on **rightsizing their cost base**
- Besides efficiency improvement mid-term **stronger lever is profitable growth**

1) Structured products, hedge funds, private equity and commodities

We have identified five key areas to improve the value proposition for our clients



- 1 First and most important issue is to **regain trust on all levels**. This requires improved communication on all levels
- 2 Institutions must become more efficient. Key initiatives include **ensuring sustainable costs and reducing complexity**
- 3 Improve customer understanding with a **meaningful customer segmentation**. Result is greater trust into the organization and it will allow the organization to focus its resources
- 4 **Redesign product offering** in line with client's situation needs and expectation. Best way to do this is by redefining the advisory process and introducing a modular solution structure with flexible components
- 5 **Align cultural, strategic and tactical levels** toward customers in order to target the right clients with appropriate services and products

The current crises is especially a crises of trust – Players must regain trust in order to ensure success

Short-term measures

- **Clear and honest communication** is essential in the current situation
- **Relationship managers** should **discuss** current **crises openly** with the client
- Bank should **support** their **relationship managers with relevant material** (e.g. pre-formulated answers and arguments)

Long-term measures

- Trust in the ability of management to perform their duties and perform them fairly (**personal trust**)
- Create sense of trust among workforce (**strategic trust**)
- Conflicts will be resolved fairly, rules and agreements will be adhered too (**organizational trust**)
- It is critical to build a truly trust-based organization

After regaining trust from stakeholders, institutions must become more efficient by ensuring sustainable costs and less complexity

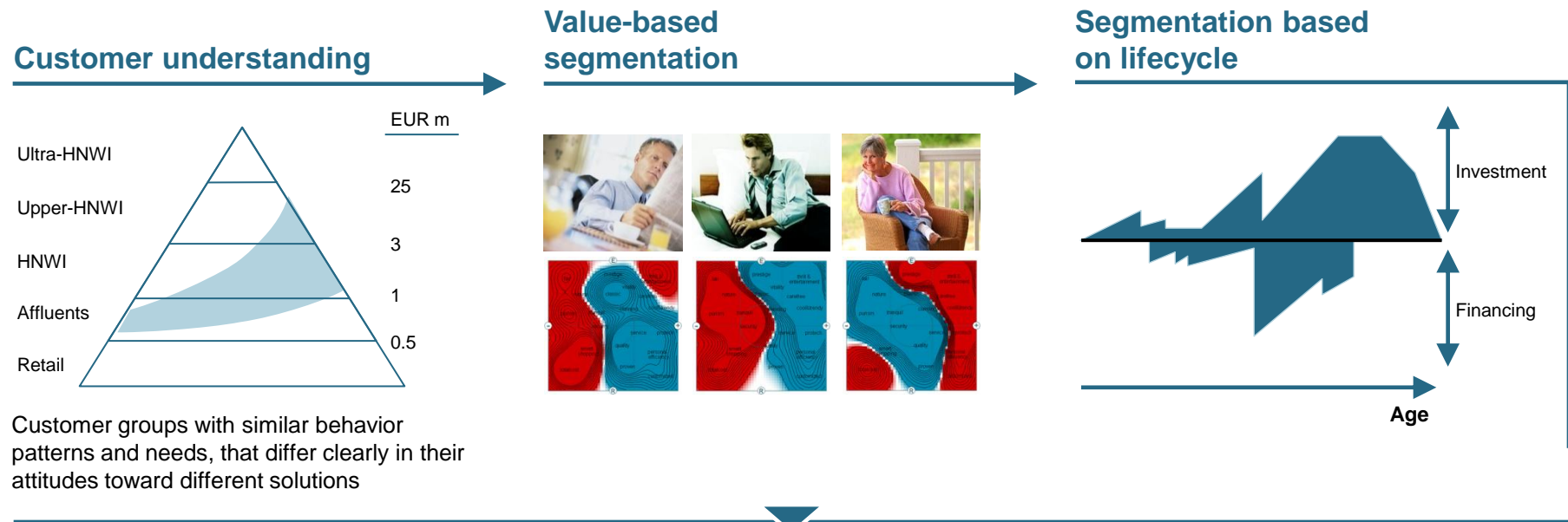
Efficiency improvement

- **Reduce costs** without jeopardizing future growth
- **Improve efficiency** in line with client's culture and mindset
- **Respect governance structures**
- **Ensure commitment** of key stakeholders within the organization

Reducing complexity

- Complexity in the offering, not paid for by clients: **streamlining** the **product shelf** can significantly reduce complexity of production and so increase profitability
- Additional complexity, paid for by clients: increasing **complexity can differentiate** the **offering**
- Non-value adding complexity in operations: Often **management concepts** improve operations **without questioning** the **value**
- Non-value adding complexity in the organization: **Structures** tend to **grow based on personal interests** and the changing balance of influence

Wealth managers must improve their customer understanding – Homogenous customers segments essential



Potential roadmap consists of the following steps and activities:

1. Segment customers into homogenous groups
2. Identify the appropriate client segment and target group
3. Communicate the new segmentation internally
4. Position the brand in the competitive landscape
5. Ensure continuous improvement of the customer understanding

After having increased the customer understanding it is relevant to realign the offering in order to address specific customer needs

1 Advice



- Basis is the standardized advisory process
- Topic specific advice through experts possible

2 Products

Account/ Paym.	Pension	Assets	...
• ...	• ...	• ...	• ...
• ...	• ...	• ...	• ...
• ...	• ...	• ...	• ...

- Active preselection of products
- Additional products by topic (modular offering)
- Bundling
- Special pricing schemes

3 Additional services



- Topic-specific information, brochures, books
- Publications and seminars
- Personalized invitations

To ensure sustainable client centricity well-measured and coordinated measures to be implemented

Hierarchy of measures to implement a client-centric organization

