Global Wealth 2016

Navigating the New Client Landscape

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NAVIGATING THE NEW CLIENT LANDSCAPE

BRENT BEARDSLEY

BRUCE HOLLEY

MARIAM JAAFAR

DANIEL KESSLER

FEDERICO MUXI

MATTHIAS NAUMANN

TJUN TANG

ANDRÉ XAVIER

ANNA ZAKRZEWSKI

June 2016 | The Boston Consulting Group

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INTRODUCTION

The growth of global private wealth hit a speed bump in 2015, especially in the developed markets, with all regions other than Japan experiencing a slowdown relative to the previous year. This development, combined with the ongoing decline of revenue and profit margins—all amid shifting client needs in both traditional and nontraditional segments—is forcing wealth managers to reevaluate their strategies.

This year's Global Wealth report includes two traditional features—the global market-sizing review and the wealth-manager benchmarking study—as well as a special examination of shifting client needs. The market-sizing chapter outlines the evolution of private wealth from both a global and regional perspective, including viewpoints on different client segments and offshore private banking. The benchmarking analysis is from a survey of more than 130 wealth managers and involves more than 1,000 data points related to growth, financial performance, operating models, sales excellence, employee efficiency, client segments, products, and trends in different markets and client domiciles.

We focused our benchmarking study this year on three trends that are altering the face of wealth management worldwide: tightening regulation, accelerating digital innovation, and shifting needs in traditional client segments. These trends have already had an impact on wealth managers' costs and profitability as banks scurry to implement new compliance measures, update their IT systems, and train their sales forces. Yet the inherent revenue potential is still largely untapped, signaling "areas for action" for agile wealth managers.

In our discussion of shifting client needs, we particularly look at how demographic and socioeconomic trends are setting the stage for the rise of nontraditional client segments—currently underserved or rising in importance—that do not necessarily fit the standard, net-worth-based service approach. Two such segments offering significant growth opportunities are female investors and so-called millennials (people born between 1980 and 2000). With investing profiles that often differ from those of others with similar levels of net worth, these two groups require a different mode of engagement that can address the mismatch between what they are seeking and what wealth managers are currently offering. A survey of more than 500 wealth-management clients led to some eye-opening findings.

In preparing this report, we used traditional segment nomenclature familiar to most wealth management institutions, dividing the client

base into categories on the basis of private wealth holdings, as follows:

- Ultra-high net worth (UHNW): more than $100 million
- Upper high net worth (upper HNW): between $20 million and $100 million
- Lower high net worth (lower HNW): between $1 million and $20 million
- Affluent: between $250,000 and $1 million

Moreover, in order to clearly gauge the evolution of private wealth in nearly 100 markets worldwide (representing more than 99 percent of global GDP in 2015), we updated our market-sizing methodology this year to reflect both the availability of enhanced data sources and new research on the topic of private financial wealth. Refinements were made in such areas as how private wealth is defined, the comprehensiveness of data on wealth distribution among client segments and regions, and how future global wealth is estimated. All growth rates are nominal with fixed exchange rates.

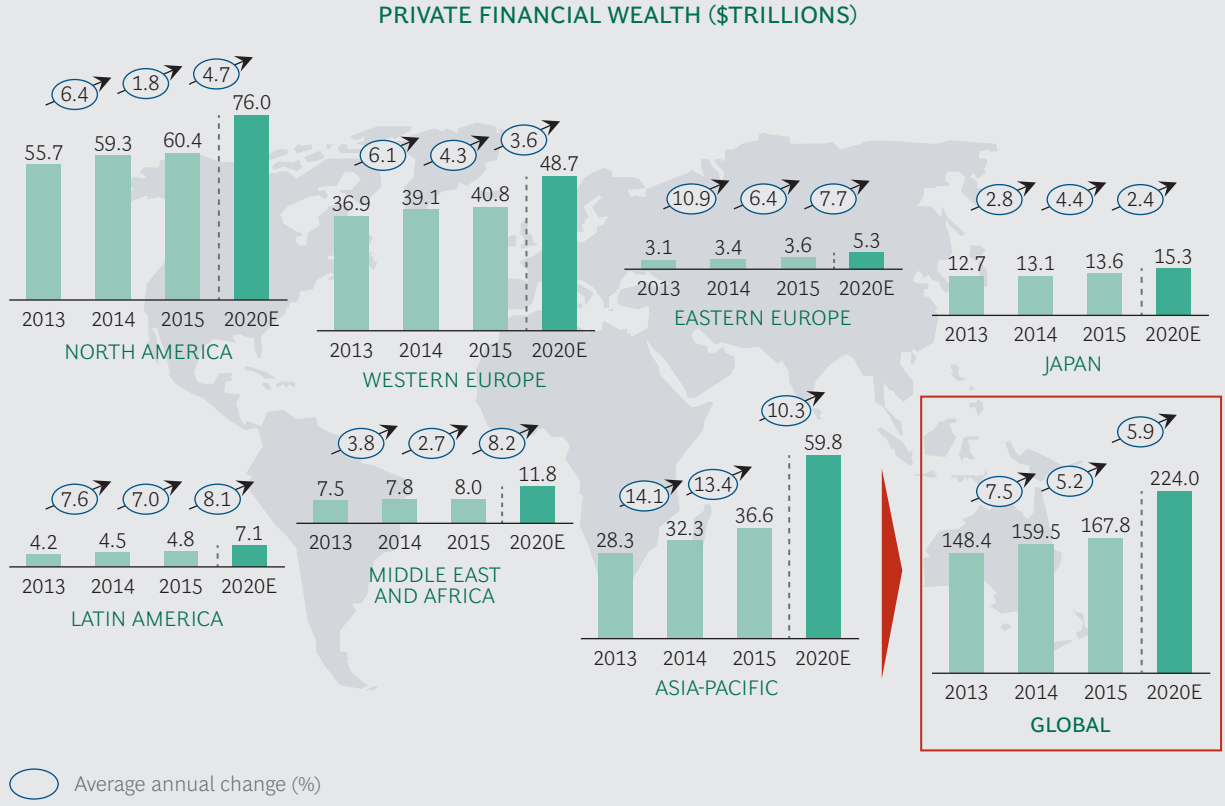
As always, our goal in *Navigating the New Client Landscape: Global Wealth 2016,* which is The Boston Consulting Group's sixteenth annual report on the global wealth-management industry, is to present a clear and complete portrait of the business, as well as to offer thought-provoking analysis of issues that will affect all types of players as they pursue their growth and profitability ambitions in the years to come. We provide a holistic view of the market, emphasizing how the entire wealth-management ecosystem interacts and where the best opportunities for wealth managers can be found.

GLOBAL WEALTH MARKETS

A SLOWDOWN IN GROWTH

GLOBAL PRIVATE FINANCIAL WEALTH grew by 5.2% in 2015 to $168 trillion.[1] (See Exhibit 1.) The rise was less than in the previous year, when global wealth rose by more than 7%. All regions except Japan, which was boosted by supportive monetary policies,

EXHIBIT 1 | Global Wealth Grew More Slowly in 2015



Source: BCG Global Wealth Market-Sizing Database, 2016.
Note: Private financial wealth is measured across all private households, and includes life insurance and pensions. All growth rates are nominal. Numbers for all years were converted to U.S. dollars at average 2015 exchange rates in order to exclude the effect of currency fluctuations. Percentage changes and global totals are based on complete (not rounded) numbers. Calculations for all years reflect updates to our methodology.

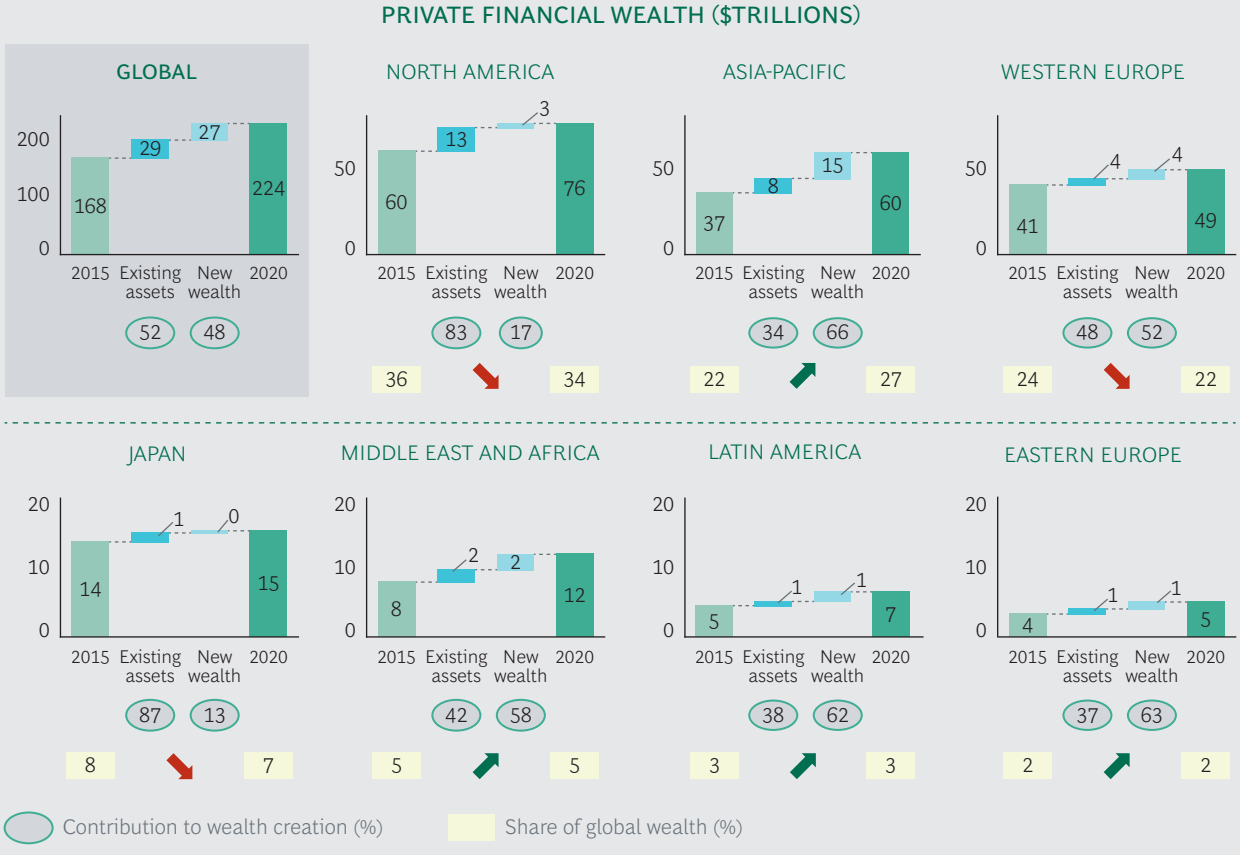
experienced slower growth than in 2014, ultimately resulting from both lower market performance and declining global GDP growth.

Unlike in recent years, the bulk of global wealth growth in 2015 was driven more by the creation of new wealth (such as rising household income) than by the performance of existing assets, as many equity and bond markets stayed fairly flat or even fell.

Significant slowdowns were seen in North America (2% in 2015 versus 6% in 2014), Eastern Europe (6% versus 11%), and Western Europe (4% versus 6%), with North America posting the lowest growth rate of any region. In Western Europe, uncertainty about the future of the European Union and continued low commodity prices weighed on equity and bond markets despite a generally promising start to the year. Some developing regions experienced significant slowdowns because of political unrest, international sanctions, and general economic tension. As in recent years, the highest growth in private wealth was seen in the Asia-Pacific region (13% in 2015, versus 14% in 2014), while the lowest growth in the developing markets occurred in the Middle East and Africa, or MEA (3% in 2015, versus 4% in 2014), where low commodity prices and political instability led to lower equity and bond markets.

If financial markets recover over the next five years, the rise of private wealth globally will return to being driven in roughly equal shares by the performance of existing assets and the creation of new wealth. (See Exhibit 2.) From a regional perspective, however, the principal driver of wealth growth will vary, with returns to existing assets dominating in North America and Japan, and newly created wealth generally playing a larger role in developing mar-

Exhibit 2 | New Wealth Will Drive Wealth Growth in Most Developing Markets



Source: BCG Global Wealth Market-Sizing Database, 2016.
Note: Private financial wealth is measured across all private households. Wealth creation from existing assets reflects returns on equities, bonds, and cash and deposits. New wealth reflects GDP growth and savings rates. All growth rates are nominal. Numbers for all years were converted to U.S. dollars at average 2015 exchange rates in order to exclude the effect of currency fluctuations. Percentage changes and global totals are based on complete (not rounded) numbers. Calculations for all years reflect updates to our methodology.

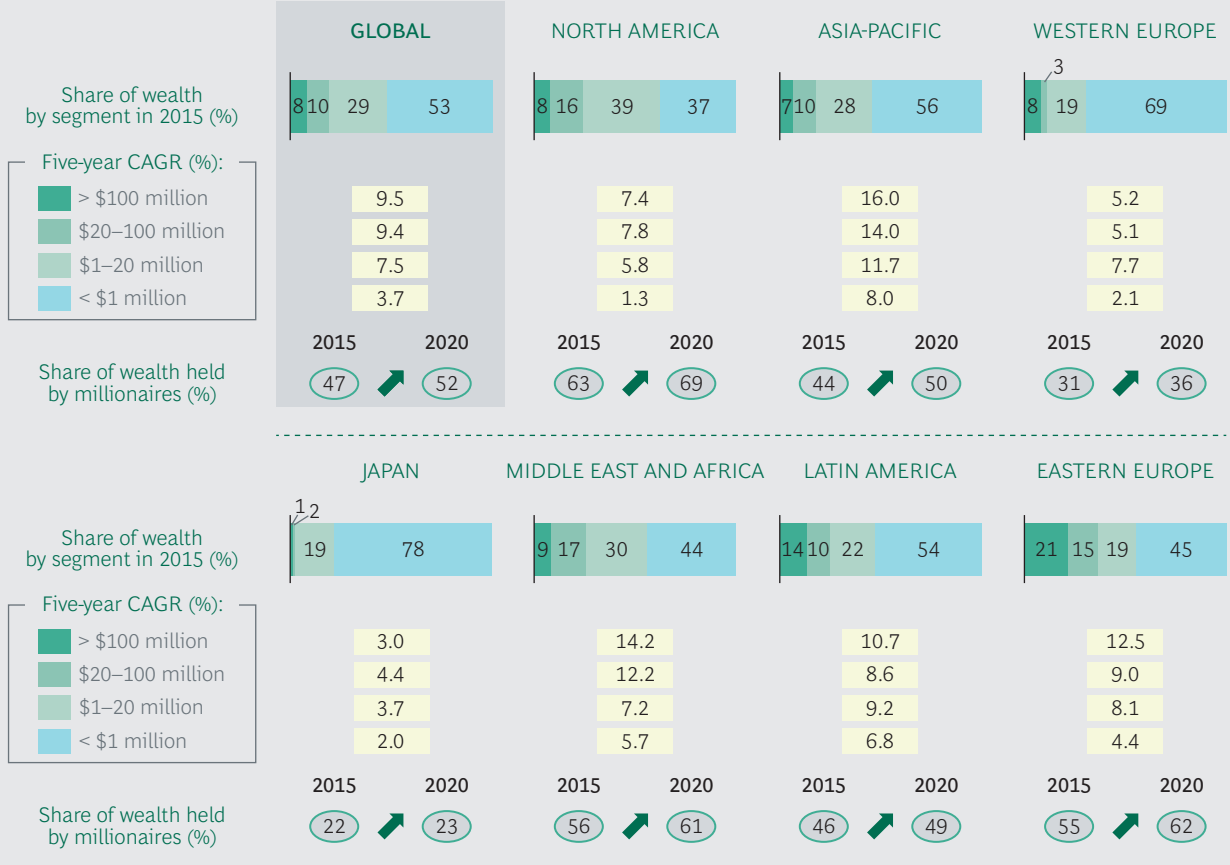
kets. As in 2015, the highest growth rates will likely be seen in Asia-Pacific, which combined with Japan is projected to overtake North America in total private wealth soon after 2020. The Asia-Pacific region is also expected to surpass Western Europe as the second-wealthiest region in 2017. Overall, private wealth globally is projected to rise at a compound annual rate of 6% over the next five years to reach $224 trillion in 2020.

In terms of wealth distribution, the upper-HNW segment saw the strongest growth in wealth in 2015 (7%), particularly in Asia-Pacific (21%). The number of millionaire households grew by 6% globally in 2015, with their share of global wealth reaching 47%—a share projected to reach 52% in 2020. (See Exhibit 3.) Several countries, particularly China and India, saw large increases in the number of millionaire households in 2015, although there were no significant shifts in millionaire density compared with 2014, with Liechtenstein and Switzerland maintaining the highest concentrations.

The vast majority of private financial wealth in 2015 was split evenly between cash and deposits on one side and equities on the other, which combined made up more than 80% of wealth assets globally. (See Exhibit 4.) Allocations varied by region, with Western Europe generally aligned with the global average, North America tilted more toward equities, and Japan dominated by cash and deposits. The picture was more uniform in developing regions, with cash and deposits typically being the most popular asset class.

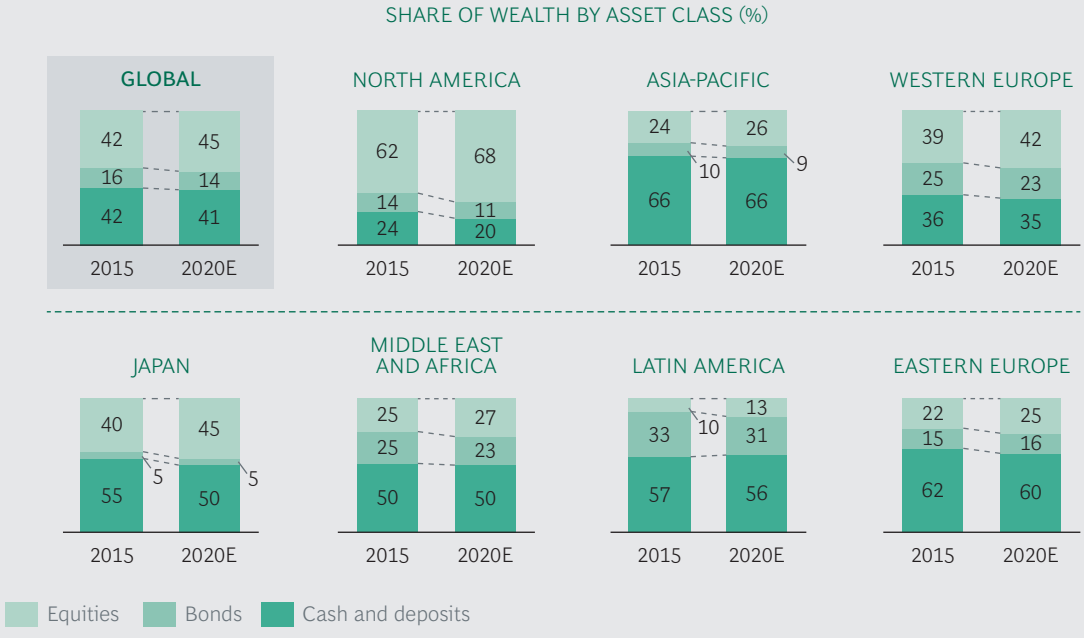
Owing to generally disappointing financial-market performance, wealth held in equities grew at lower rates in 2015 than in recent

Exhibit 3 | Millionaire Households Will Hold More Than Half of Global Private Wealth in 2020



Source: BCG Global Wealth Market-Sizing Database, 2016.
Note: Private financial wealth is measured across all private households. Millionaires are defined as households with financial wealth of at least $1 million. All growth rates are nominal. Numbers for all years were converted to U.S. dollars at average 2015 exchange rates in order to exclude the effect of currency fluctuations. Percentage changes and global totals are based on complete (not rounded) numbers; percentage wealth shares may not add to 100 because of rounding. Calculations for all years reflect updates to our methodology. CAGR is the compound annual growth rate.

EXHIBIT 4 | Asset Allocations Will Increasingly Tilt Toward Equities Through 2020



Source: BCG Global Wealth Market-Sizing Database, 2016.
Note: Private financial wealth is measured across all private households. Numbers for all years were converted to U.S. dollars at average 2015 exchange rates in order to exclude the effect of currency fluctuations. Percentages may not add to 100 because of rounding. Calculations for all years reflect updates to our methodology.

years. If financial markets recover, assets will be expected to increasingly tilt toward equities over the next five years rather than cash and deposits or bonds, which in a low-interest-rate environment will continue to be less-attractive asset classes.

Highlights by Region

North America.[2] Private wealth in North America grew by less than 2% to $60 trillion in 2015, compared with a 6% rise a year earlier. The Dow and the S&P 500 closed the year with negative returns for the first time since 2008, and the meager wealth growth that did occur in 2015 stemmed mainly from rising household income.

The November 2016 U.S. election is still a wild card with regard to its effect on financial markets. With a respectable stock market recovery, however, North American private wealth is expected to grow by nearly 5% per year to reach $76 trillion in 2020. The U.S. will remain the world's wealthiest country, although North America is expected to be surpassed by Asia-Pacific (including Japan) soon after 2020.

The lower-HNW segment experienced the slowest wealth growth in North America in 2015, while the upper-HNW segment posted the strongest expansion, although still at a modest rate (2%). Millionaire households continued to control the majority of private wealth in North America (63%), the highest share of all regions. With a higher allocation to equities, wealth held by these households is expected to grow at a significantly higher rate than that of nonmillionaire households through 2020. In general, 62% of North American private wealth was held in equities in 2015, the highest share of all regions.

Western Europe.[3] Western Europe posted private wealth growth of 4% in 2015, down from 6% a year earlier, despite a policy of quantitative easing by the European Central Bank.

The growth that was achieved was driven primarily by the performance of existing assets, albeit with some differences in equity market performance among countries. France and Italy, for example, enjoyed positive stock market performance, while U.K. equities were in negative territory, partly driven by a drop

in the commodity sector. Regional wealth growth is expected to continue at rates similar to those in recent years, although this expansion could be held back by the low-interest-rate environment and the potential exit of Great Britain from the European Union. Further pressure could come from economic slowdowns in countries outside the region—such as China—in which Western European nations have high investment stakes.

In terms of wealth segments, the highest growth in Western Europe was registered by the lower-HNW segment (9%), with wealth held by the UHNW segment growing by 5%. There was variation among countries depending on specific stock-market results.

Equities stayed just ahead of cash and deposits as the most popular asset class in Western Europe. Over the next five years, the share of Western European wealth held in equities is expected to increase.

Eastern Europe.[4] Private wealth in Eastern Europe grew by more than 6% to nearly $4 trillion in 2015, although significantly lower than the 11% growth posted in 2014. The expansion that did take place was driven at a regional level by rising household income, given that both equities and bonds had negative returns in some markets. Russia's markedly slower growth in 2015 (8%, compared with 19% in 2014) was partly the result of lower commodity prices, international sanctions, and the conflict with Ukraine. On the positive side, the Russian central bank's efforts to ease monetary policy and reduce interest rates allowed private wealth in the country to grow more substantially than in other regional markets.

Poland and the Czech Republic, the region's two wealthiest countries after Russia, witnessed reasonable growth, while Ukrainian wealth declined by 6% largely as a result of political instability. With markets predicted to recover and commodity prices rising again, Eastern European wealth is expected to expand more strongly over the next five years, driven mainly by Russian wealth.

In terms of wealth distribution, the UHNW segment saw the most robust growth in Eastern Europe in 2015, with upper-HNW households also showing strength. Wealth held by both of these segments is expected to grow more rapidly through 2020—12% for the UHNW segment and 9% for upper-HNW households. The share of wealth held by millionaire households is expected to increase from 55% to 62% in 2020.

In terms of asset allocation, the highest share of Eastern European wealth remained invested in cash and deposits in 2015. The share of equities and bonds is expected to increase through 2020 at the expense of cash and deposits. Asia-Pacific was the only region to post double-digit wealth growth in 2015.

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Asia-Pacific.[5] Asia-Pacific was the only region to post double-digit growth in 2015, as private wealth rose by 13% to $37 trillion. The expansion was driven more by rising household income than by asset performance, as the entire region experienced high volatility in financial markets. China remained the principal growth motor in the region. Asia-Pacific wealth growth is expected to continue through 2020, although at a less-rapid pace than in 2015, owing to probable ongoing market volatility across the region and a lower level of GDP growth in China. Overall, Asia-Pacific will continue to gain share in total global wealth through 2020 (from 22% in 2015 to an estimated 27% in 2020), driven mostly by the creation of new wealth as opposed to the performance of existing assets.

The upper-HNW segment posted the strongest growth in 2015, although this expansion is expected to lose some momentum in the run-up to 2020. The UHNW segment also achieved robust wealth growth in 2015 (15%), and is expected to grow at even higher annual rates until 2020 (16%), making it the fastest-growing segment in the region. As in all other regions, wealth held by millionaire

households in Asia-Pacific is expected to grow faster than that held by nonmillionaire households, raising the share of wealth held by the former to 50% in 2020.

The highest share of Japanese wealth was held in cash and deposits in 2015.

The highest share of Asia-Pacific wealth remained invested in cash and deposits, although the trend was moving somewhat toward equities. Bonds lost ground in 2015, a downward trajectory that is expected to continue through 2020.

Japan. Private wealth in Japan grew by 4% to $14 trillion in 2015, a higher rate than the 3% posted in 2014, making Japan the only region whose wealth growth surpassed that of the previous year. The growth in wealth in Japan was generated more from the performance of existing assets than from new wealth creation, as equities performed fairly well. In addition, corporate profits were strong and the central bank injected more money into the market. Wealth growth is expected to moderate through 2020 as capital investment and consumer spending remain sluggish, the low-interest-rate environment persists, and exports are dampened by decelerating growth in China.

The upper-HNW segment posted double-digit wealth growth in 2015 (13%), although this expansion is expected to slow through 2020 (to 4% annually) with its overall share of Japanese wealth remaining modest (2%). The lower-HNW segment should continue to hold nearly one-fifth of all Japanese wealth. Wealth held by millionaire households is expected to grow faster than that held by nonmillionaire households, but the difference in their growth rates will be modest, with Japan continuing to have a low share of wealth held by millionaire households (23%) in 2020.

In terms of asset allocation—and in contrast to other developed regions where equities are generally the preferred asset class—the highest share of Japanese wealth was held in cash and deposits in 2015. Wealth held in equities grew the most robustly, and is expected to continue to grow at a strong pace. Bonds will remain a less-attractive asset class given the low-interest-rate climate.

Latin America.[6] Private wealth in Latin America grew by 7% to $5 trillion in 2015, a somewhat lower rate than the nearly 8% gain registered in 2014. Wealth expansion was reined in by poor equity-market performance in the two largest economies, Brazil and Mexico, which hold more than half the region's wealth. Having suffered from the fading commodity- and consumption-driven boom, these and other economies in the region have found themselves at a crossroads. Future economic growth, and with it future wealth growth, will depend on the choices made in the next electoral cycles.

There were no significant shifts of Latin American wealth across segments in 2015. Wealth held by the UHNW as well as by the upper- and lower-HNW segments is expected to grow by 9% to 11% per year through 2020 owing to the anticipated equity-market recovery. The higher expected growth of wealth held by millionaire households (compared with that held by nonmillionaire households) will increase the former's share of regional wealth to a projected 49% in 2020.

More than half of Latin American wealth remained invested in cash and deposits in 2015. In Brazil, however, the largest share of wealth remained in bonds. The share of wealth held in equities is expected to increase in the region through 2020.

Middle East and Africa.[7] The level of private wealth in MEA grew by less than 3% in 2015 to $8 trillion, which was lower than the 4% rise registered a year earlier and the second-lowest rate of any region globally. The slow growth was largely the result of negative equity-market performance in two key economies, Saudi Arabia and Nigeria, which account for roughly a third of the region's wealth. The growth that did occur reflected rising household income. Nevertheless, if commodity prices recover and political tensions ease,

stock markets can be expected to improve through 2020, fueling private wealth growth.

Wealth distribution was unchanged in MEA in 2015, with no significant shifts among segments. Millionaire households, already holding more than half of all regional wealth in 2015, are expected to see their share grow over the next five years. Roughly half of MEA wealth remained invested in cash and deposits in 2015, but the share of equity-based wealth is expected to rise.

The Offshore Perspective

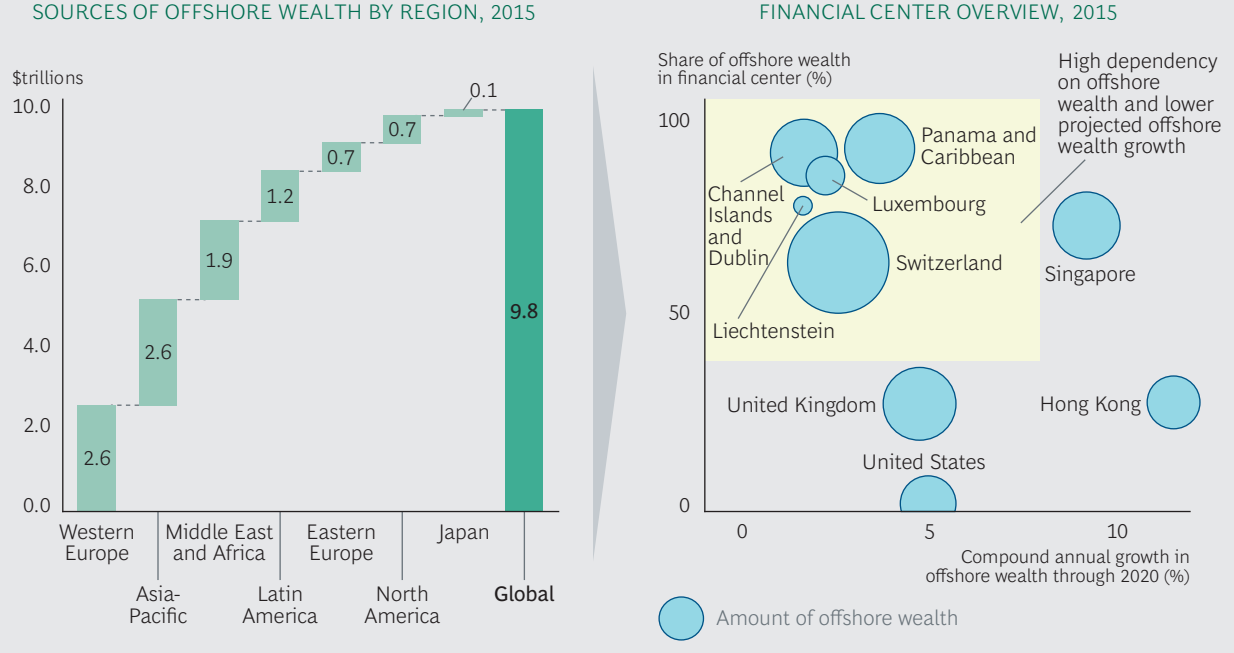
Private wealth booked in offshore centers grew by about 3% in 2015 to almost $10 trillion. A key factor was the strong repatriation of offshore assets by investors in developed markets. Indeed, offshore wealth held by investors in North America, Western Europe, and Japan declined by 3% in 2015.

On a regional basis, the largest sources of offshore wealth were Western Europe (mainly the U.K., Germany, and France), Asia-Pacific (mainly China, Taiwan, Hong Kong, and Indonesia), and MEA (mainly Saudi Arabia, Nigeria, and the United Arab Emirates). (See Exhibit 5.) The top three source countries were China, the U.S., and the U.K., although their offshore shares relative to total wealth varied significantly (1% for the U.S. versus 6% for the U.K.).

Overall, the shift from developed regions (the "old" world) to developing regions (the "new" world) as the primary source of offshore wealth has become more pronounced. Today, 65% of offshore wealth originates from the new world, compared with 57% five years ago. In addition, the share of wealth held offshore varies significantly among regions, with MEA and Latin America being the front-runners, both with roughly 25% of total private wealth held offshore. In these regions, economic and political tensions (as well as access to financial products not available onshore) have continued to contribute to the flow of wealth offshore as investors actively search for the most attractive locations in which to domicile their assets.

The annual growth of offshore wealth globally is expected to pick up again through 2020,

Exhibit 5 | Western Europe and Asia-Pacific Were the Top Sources of Offshore Wealth in 2015



Source: BCG Global Wealth Market-Sizing Database, 2016.
Note: Private financial wealth is measured across all private households. Offshore wealth is defined as wealth booked in a country other than a person's country of residence or domicile. All growth rates are nominal. Numbers for all years were converted to U.S. dollars at average 2015 exchange rates in order to exclude the effect of currency fluctuations. Percentage changes and global totals are based on complete (not rounded) numbers. Calculations for all years reflect updates to our methodology.

although at a lower rate than onshore wealth (5% versus 6%). One factor is that although regulatory measures aimed at fighting tax evasion will continue to persuade some old-world investors to repatriate their wealth, regulation also stabilizes the market and provides new opportunities to move fully taxed wealth offshore in search of better service quality, product diversity, and economic stability. Offshore wealth originating in the old world is expected to show positive growth again (2% annually through 2020, compared with 6% sourced from the new world). Nonetheless, the overall share of total global wealth booked offshore is projected to decrease from 6% in 2015 to an estimated 5% in 2020.

Switzerland is expected to remain the largest single offshore center through 2020.

Among offshore centers, Hong Kong and Singapore saw the strongest growth (about 10%) in 2015. Switzerland remained the largest destination for offshore wealth, holding nearly one-quarter of all offshore assets globally, followed by the U.K. and the Caribbean, including Panama.

The outlook for offshore centers located in the new world remains positive given their proximity to high-growth regions. Offshore wealth booked in Hong Kong and Singapore is projected to grow at roughly 10% annually through 2020, increasing their combined share of the world's offshore assets from roughly 18% in 2015 to 23% in 2020. Despite the high projected growth of most new-world offshore centers, Switzerland is expected to remain the largest single center through 2020 owing to its high service quality, diverse product offerings, political stability, safe-haven currency, and attractive location in the center of Europe.

The Shifting Competitive Climate Among Offshore Players. While the reasons that many investors send assets offshore remain more or less the same, the provider side is changing significantly. Indeed, many banks with offshore operations are engaged in rigorous portfolio analyses. Their objectives are essentially threefold: reducing regulatory risks, achieving scale and growth, and focusing on the core business.

- *Reducing Regulatory Risks.* The rapidly rising cost of ensuring regulatory compliance, especially with regard to anti-money-laundering and tax compliance rules, is making it very difficult for offshore banks to remain active in smaller markets. Some banks have shed assets originating from clients in certain domiciles in order to reduce not only complexity along the value chain but also operational and reputational risks.

- *Achieving Scale and Growth.* Amid the rising cost of doing business, reflecting not only regulatory measures but also the ongoing need for IT investment, banks that lack scale and the resources to expand will continue to face pressure to consolidate. Many have been active on the M&A front. In addition, with regulatory frameworks such as the so-called European passport (which grants a bank licensed in any EU member state the right to operate freely across the European Economic Area), a number of players have begun to regionalize their wealth-management operations, effectively blurring the lines between onshore and offshore bookings. Domiciles such as the U.K. and Luxembourg have attracted a number of Chinese, Russian, Middle Eastern, and Swiss wealth-management institutions that have ambitions to serve the entire European market.

- *Focusing on the Core Business.* The complexity of managing too many domiciles has prompted some larger offshore banks to retrench and concentrate their businesses in core markets, exiting regional or more far-flung areas. This trend, in addition to the search for scale among smaller players, has contributed to consolidation across the offshore industry. And with our offshore-focused benchmarking participants in 2015 each still serving an average of 108 client domiciles, the peak of

consolidation has likely not been reached. M&A activity may also give nontraditional players an opportunity to enter the market, as some retail and investment banks have already done.

Evolving Front-Office Models. With the emphasis shifting to core domiciles, front-office structures are becoming more team-based and market-focused. Given increased service complexity and more onerous compliance requirements, relationship managers (RMs) are concentrating on fewer markets. For banks that have made this transition in their operating models, the number of markets served per RM has decreased from an average of 15 to 20 to an average of 3 to 5 in any specific region.

Client Interaction with RMs. The level of interaction between offshore clients and their RMs has increased. This trend is due to both difficult market conditions (such as low interest rates and high stock-market volatility) and the amount of client information banks must gather to satisfy new transparency obligations. Although digital technology can help make processes smoother, banks need to obtain detailed histories of clients and their sources of wealth and fully adhere to all relevant regulatory and compliance standards. Such requirements are making offshore banking more resource-intensive, leading to front-office costs per client that are close to those of onshore operations (21 basis points on client assets and liabilities). Nonetheless, more frequent interaction should also provide opportunities for wealth managers to serve clients better. The value propositions of leading offshore bankers are putting more emphasis on service models that are highly customized by market, region, and segment, since being offshore is no longer an attractive selling proposition in and of itself.

Notes

1. Private financial wealth includes cash and deposits, mutual funds, listed and unlisted equities, debt securities, life insurance payments, and pension entitlements, all either held directly or indirectly through managed investments, and held either onshore or offshore. It excludes investors' residences and luxury goods. Wealth figures and percentage changes are based on local totals that were converted to U.S. dollars using year-average 2015 exchange rates for all years in order to exclude the effect of currency fluctuations.
2. Canada and the United States.
3. Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Ireland, Israel, Italy, Liechtenstein, Luxembourg, Malta, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.
4. Azerbaijan, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Kazakhstan, Latvia, Lithuania, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkmenistan, Ukraine, and Uzbekistan.
5. Australia, Bangladesh, China, Hong Kong, India, Indonesia, Malaysia, Myanmar, New Zealand, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Taiwan, Thailand, and Vietnam.
6. Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Mexico, Panama, Peru, Uruguay, and Venezuela.
7. Algeria, Angola, Bahrain, Egypt, Ethiopia, Iran, Iraq, Jordan, Kenya, Kuwait, Lebanon, Libya, Morocco, Nigeria, Oman, Qatar, Saudi Arabia, South Africa, Sudan, Syria, Tanzania, Tunisia, Turkey, United Arab Emirates, and Yemen.

THREE AREAS FOR ACTION BY WEALTH MANAGERS

For 14 years, BCG has conducted a proprietary benchmarking survey of wealth management providers from all over the world, running the spectrum from small boutiques to the world's largest wealth managers—and covering multiple business models, from onshore to offshore and from banking to brokerage. A key finding in this year's benchmarking is that average revenue and profit margins declined for wealth managers from 2012 to 2015. (See Exhibit 6.)

This development underlines the need for new strategies and approaches. Three major trends have altered—and will continue to alter—the face of wealth management: tightening regulation, accelerating digital innovation, and shifting needs in traditional wealth-based client segments.

Tightening Regulation

Regulators worldwide remain determined to increase transparency in the products, prices, and processes of wealth managers. Their overall goal is to eliminate conflicts of interest, help investors understand increasingly complex financial products, and ultimately strengthen investor protection. For example, more and more countries are prohibiting inducement fees, through such means as the Markets in Financial Instruments Directive II (MiFID II) in Europe, the Retail Distribution Review (RDR) in the U.K., the Future of Financial Advice (FOFA) in Australia, and the U.S. Department of Labor's so-called fiduciary rule. This last rule, which will take full effect over the next 12 to 18 months, requires financial advisors handling retirement accounts to put the best interests of their clients above their own profit goals. It remains to be seen whether the commission-based models of many broker-dealers in the U.S. market can coexist with this new fiduciary-duty rule.

Average revenue and profit margins declined for wealth managers from 2012 to 2015.

Such regulatory steps will have a significant impact on wealth managers' revenue potential in several ways: by putting pressure on fees and charges (through increased transparency); by limiting the products that can be offered on an execution-only basis without advice and proof of suitability (or of acting in the client's best interest); and by restricting (or eliminating) inducement payments as a source of revenue. In 2015, our global wealth-manager survey respondents in regions where regulation is not yet in place derived 21% of their revenues from inducement fees and commissions (down from 24% in 2014), indicating a high level of dependence.

Exhibit 6 | Revenue and Profit Margins Declined from 2012 to 2015, Although Cost and FTE Metrics Improved

Source: BCG Wealth Manager Performance Databases, 2013 and 2016.
Note: This analysis is based in U.S. dollars for all institutions. AuM is assets under management. Averages are weighted by CAL (client assets and liabilities). Figures for 2012 and 2015 are for an identical sample of institutions; hence, figures for 2012 may deviate from previous reports.
[1]Primarily private banks from Switzerland, Luxembourg, and Liechtenstein.
[2]Excludes Japanese institutions.
[3]Excludes broker-dealers.
[4]Revenues divided by yearly average CAL.
[5]Operating costs divided by yearly average CAL.
[6]Revenues less total costs, divided by yearly average CAL.

In regions where regulation is about to be implemented, the share has already decreased to an average of 9%.

In addition to reducing revenues, regulatory measures will also increase costs for wealth managers as new systems, processes, and controls are put in place to ensure compliance, and as liability risk increases—with potentially severe financial penalties and reputational damage resulting from noncompliance. For our survey participants, legal and compliance costs have increased to 4% of total operating expenses, double the 2% average in 2012. According to Expand Research, a subsidiary of BCG, regulatory spending can represent up to 13% of IT costs, especially for smaller regional players.

Moreover, operational complexity will rise, with advice to clients requiring documentation and proof of suitability (or of acting in the client's best interest). Costs will also have to be fully disclosed and broken down into categories, with any inducement fees and other potential conflicts of interest revealed. Relationship manager roles will need to continuously adapt to new regimes.

Of course, the new environment has a positive side in that nimble, highly skilled wealth managers can turn the challenge into an opportunity by creating compelling advisory offerings—often leveraging investment specialists—targeted at self-directed clients who wish to participate in their own investment choices. Although the share of client assets under advisement (either centrally or through the RM) increased to 19% in 2015 among our survey respondents, there is still enormous potential in the 46% of self-directed client

assets that currently receive no contractually defined advice. For banks, increasing the advisory share is lucrative and carries the potential to raise client satisfaction and loyalty. On average, an advisory mandate delivers returns on assets that are 22 basis points higher than pure execution models, according to our survey.

Of course, the chief opportunity lies in creating clearly defined levels of advisory service that the client is willing to pay for, systematically injecting the bank's research capabilities into individualized investment recommendations, and providing compelling digital services. Overall, the bank's sales pitch becomes the following: "We will help you to find the right investments, and you will be able to monitor them continuously and interactively." Varying levels of advice should be available to all clients regardless of net worth, although standard underlying services and products should be streamlined, using robo-advisors and fixed-fee models for smaller clients and teams of experts for larger, more complex client portfolios. In 2015, 82% of our survey respondents still provided affluent clients with RM-centric service. Nonetheless, this model may not be economically viable once new regulations come fully into force—as evidenced in markets such as the U.K., where smaller clients are increasingly less likely to receive personalized financial advice.

The RM-centric model may not be viable once new regulations come fully into force.

By shifting toward diverse product packages—in particular by moving from execution-only to fee-based advisory services—wealth managers can potentially complement commissions with more predictable revenue streams. We are already observing a shift away from commissions to recurring fees. Among our survey respondents, fee-based revenues represented 43% of total revenues in 2015, compared with 38% in 2012. There is even greater potential in customizing pricing plans on the basis of clients' product needs and activity levels—as well as on their overall value to the organization.

A successful, systematic advisory process should cover structured client-book planning (weekly and daily coverage) and implement sales targets with clear KPIs linked to incentives. A big element of developing such a process is rigorous RM training. Among our survey respondents, the average cost of training per RM in 2015 was roughly $1,000, a figure that will likely need to increase. Effective RM training can result in a front line that truly understands client goals and risk profiles and is able to deliver holistic advice that goes beyond short- and medium-term investments—which are close to becoming commoditized, partly because of regulatory restrictions—to include broader advice that encompasses lifestyle choices and long-term financial objectives.

Accelerating Digital Innovation

With the rise of financial technology firms and the rapid evolution of smart analytics (or big data), digital technology is changing the rules of the wealth management industry. Most players are committed to making digital transformation a top priority. Fully 97% of our survey respondents said that they planned to invest in digital capabilities, and 64% believe that digital capabilities would be the key to serving the next generation of wealthy clients. Clients themselves have also voiced a need for digital engagement, indicating that it provides a noninvasive and efficient way for them to receive effective service. Nonetheless, many wealth managers are still trying to figure out how to derive value from their investments in digital capabilities.

Indeed, the time for action is ripe. We estimate that the number of asset- and wealth-management-focused financial technology companies has more than doubled, from roughly 315 (with funding of $1.7 billion) in 2012 to about 700 (with funding of $4.9 billion) in 2015. These companies are known primarily for low-cost, algorithm-based asset-allocating platforms (or robo-advisors), but they also offer digital advice, portfolio composition, and execution, as well as customized portfolio optimization and recom-

mendations for HNW clients. They tend to specialize in certain steps of the value chain, particularly in finding the best investment solutions for clients and interacting with them. By contrast, most traditional wealth managers cover the entire value chain and struggle with digital capabilities.

Big data is also playing a key role in revolutionizing the industry. In the past, most wealth managers were limited to analytics for financial reporting and control. Today, big data has evolved to the point where enormous amounts of unstructured internal and external data can be processed within very short time periods, greatly enhancing the ability to predict clients' product preferences, accurately gauge the regulatory compliance level of both clients and RMs, and prevent fraud, among other uses. Wealth managers that seamlessly inject analytics-based insight into client interactions will be able to increase their share of wallet through highly tailored services—taking a page from luxury-goods firms and other consumer-centric sectors and possibly changing the way investment solutions are identified and proposed.

In our view, wealth managers need an entirely new perspective on digital capabilities if they hope to tap the full potential and unlock multiple opportunities across their business models, particularly in the areas of revenue enhancement, cost optimization, and operational effectiveness.

Revenue Enhancement. Smart analytics allow for precise customer targeting through both descriptive and predictive analysis. For example, a trading-oriented client with a high risk tolerance will have markedly different research requirements, price sensitivities, and investment horizons than a client who delegates investment decisions. Wealth managers now have the opportunity to use behavioral, demographic, and lifestyle data to think ahead of the client in determining the next logical investment.

Providing clients with quality advice and products at the right time through the best channel—increasingly a digital channel—will dramatically improve the client experience, which will ultimately lead to increased client trust and loyalty and a higher level of activity and interaction. Many wealth managers still dramatically lag behind in providing the digital services that clients are accustomed to receiving from retail banks and consumer-goods companies. Current digital offerings are not compelling enough to engage the client, and are not built around the few key client journeys that truly make a difference. Ultimately, the combination of better digital engagement and smart analytics has the potential to lift revenues significantly.

Current digital offerings are not compelling enough to engage the client.

Cost Optimization. Middle- and back-office costs accounted for 53% of total costs for our wealth-manager survey respondents. Investments in digital technology are a significant part of these costs. According to Expand Research, client and advisor technology now makes up 29% of total IT spending, on average, up from 23% in 2013 for a representative sample of wealth managers. This trend is driven primarily by the need to establish a sophisticated digital foundation and by the potential that wealth managers see in pursuing digital capabilities in the long run. Many IT organizations have focused on providing the front office with better self-directed tools in order to drive productivity and improve the client experience through a more effective digital platform.

From a long-term perspective, however, digital technology gives wealth managers the opportunity to serve affluent clients efficiently through a lower-cost, commoditized approach. Furthermore, wealth managers can leverage technology to reduce costs in portfolio management, research and product development, operations, risk compliance, and other support functions—while also leveraging sophisticated communication and advice tools that enhance the offering for HNW and UHNW individuals. Financial technology companies are leading the way with innovative ideas in this space.

Operational Effectiveness. A properly implemented digital initiative provides a huge opportunity to standardize and simplify processes, identify areas to insource and outsource, and work jointly with other players to create efficiency gains, especially in the middle and back offices. Wealth managers must therefore understand that digital technology is not just another silo next to their traditional business model but rather a change in their DNA, requiring systematic process redesign and integration with legacy elements. This realization can lay the foundation for focusing on the links in the value chain where wealth managers can truly differentiate themselves.

It is important to note that a comprehensive digital initiative cannot be based on incremental improvements, as has often been the case in the past, with multiyear projects driven by the IT department—nor can it be based on building a digital incubator lab that operates in an ivory tower with no connections to the day-to-day business. Focused prototypes must quickly be produced, tested, and improved, and innovations should be managed as a portfolio, not unlike a venture capital fund. Partnering with or even acquiring financial technology firms is an option for obtaining relevant capabilities at the speed required in today's rapidly changing environment.

Digital technology is not just another silo next to the traditional business model.

Of course, increasing digital interaction with clients poses its own set of threats in the form of cyber attacks and data leakage, and any incidents involving HNW and UHNW clients can potentially bring about reputational damage. Wealth managers must therefore ensure that proper infrastructure and security protocols are continuously upgraded to reflect the latest developments and threat patterns.

In order to be truly digitally transformed, wealth managers will need to redesign their entire business model and organization. The sales force must be brought on board, and great care must be taken to ensure that digital innovations and channels not only avoid putting pressure on margins but actually strengthen them. Only those players agile enough to keep up with the nimblest digital disruptors will prevail.

Shifting Needs in Traditional Client Segments

Upper-HNW households (with wealth of more than $20 million) and UHNW households (with wealth of more than $100 million) are the fastest-growing client segments, holding a combined 18% of global wealth in 2015. Nearly all of our wealth-manager survey respondents claimed to serve the over–$20 million segment, with 67% saying they wished to increase their share. Nonetheless, the diversity and complexity of the households that make up this category, as well as their investment needs, are evolving so rapidly that it is worth reassessing these segments.

Given the challenges of managing large investments across multiple jurisdictions, it is not surprising that very wealthy people typically need many banking relationships (roughly three to five) in order to find all of the products and services they need—including high-level portfolio management, estate planning, and tax advice covering multiple asset classes and countries. Individuals at this wealth level also typically seek diversity. In our survey of wealth management *clients* (our "client needs" survey, which included interviews), more than 80% of the over–$20 million segment expressed a willingness to invest in both alternative products and emerging markets. Socially conscious products were not seen as critical offerings, nor were social platforms that involve other investors. Crowd-funding platforms were cited as interesting by 30% of respondents.

People with more than $20 million in wealth tend to be knowledgeable about investment strategies as well as more self-directed—although they are also typically interested in close interaction with the professionals who manage their money. According to our client-needs survey, they rely first on themselves for investment decisions and on their advi-

sors second, although they are especially concerned with feeling comfortable that their assets are being looked after carefully and securely. Most are interested in long-term wealth preservation as well as short-term wealth growth. Excellent investment performance as well as price transparency are, of course, key considerations in choosing a wealth manager.

More than three-fourths (79%) of respondents in our wealth-manager survey serve their clients at this level with specialized teams that are fully dedicated to managing their complex needs. Nonetheless, 15% of wealth managers also said that they had RMs and teams that served *all* segments—which can increase the risk of overserving smaller clients at the expense of larger ones. Players that offer truly customized attention to the over–$20 million segment will also benefit from client referrals among this highly exclusive network of people. According to our client-needs survey, the vast majority of such clients leverage referrals from other investors.

Another important segment is affluent clients, with between $250,000 and $1 million in financial wealth. These clients make up the heavy middle part of the wealth pyramid, holding 30% of global wealth and representing 6% of households. We see this group as a type of emerging segment, particularly since it has not historically been a target for most wealth managers and is losing even more appeal in a world of regulated advice. While all of the respondents in our wealth-manager survey said that they served the affluent segment, 58% of wealth managers said they planned to decrease their share over the coming three years. In our view, this may be a missed opportunity, as gaining share among affluent clients is a relatively direct way to generate revenues through volume, using a standardized service model that is appropriate to clients whose investment needs are typically straightforward. In addition, clients that move from the affluent segment into the HNW segment will have learned the benefits of professional wealth-management services early on.

Our client-needs survey showed that affluent investors are very price sensitive, although many do not understand their actual fee level. For 71% of our respondents, fee levels were a top-three criterion in choosing a wealth manager, which is particularly relevant in the current environment of increasing fee transparency. To minimize fees, most affluent clients maintain a low number of banking relationships. A wide variety of products is typically less important to them than price considerations.

Although affluent clients are relatively small investors, they tend to be very engaged.

Moreover, although affluent clients are relatively small investors, they tend to be engaged. Half of our survey respondents said they had an appetite for actively trying to enhance their returns—preferring to base their investments on their own opinions—and they typically use online sources to gather investment information and advice. Wealth managers therefore have an opportunity to convince affluent clients of the value that they can provide.

Digital capabilities are important for this segment, as affluent clients are accustomed to using a range of digital channels with their retail banks. They expect an intuitive digital process for advisory services from their wealth managers. One-third of our client-needs survey respondents cited digital sophistication as a top reason for choosing a wealth manager, yet only 7% of our wealth-manager survey respondents said that they had a targeted and individualized digital platform. Next to meeting clients' demands, technology is also the most cost-efficient and regulation-compliant way to serve affluent clients.

Across all segments, wealth managers must recognize that properly articulated value propositions should take a client-centric perspective and describe specific benefits in terms of service levels, products, and interaction channels—as well as the cost to the client. Skillful execution in this domain will lay the foundation for providing a unique and engaging client experience.

NEW STRATEGIES FOR NONTRADITIONAL CLIENT SEGMENTS

Although wealth managers have historically segmented their clients on the basis of wealth level, service models for the various segments have remained fairly uniform. (See Exhibit 7.) Yet demographic and socioeconomic shifts are setting the stage for the rise of nontraditional, underserved segments that do not fit the standard approach.

Most wealth managers try to fit nontraditional clients into a traditional framework.

The vast majority of wealth managers still try to fit nontraditional segments into the traditional wealth-based framework, grouping them with clients whose investment and service needs may be significantly different. By not taking a more customized perspective, wealth managers risk client attrition and will potentially miss out on future growth opportunities. Existing cost-to-serve models often reveal a lack of understanding of what nontraditional segments are specifically willing to pay for, resulting in forgone revenues. Filling this gap presents a significant opportunity.

There are two client groups whose investment needs and market potential merit special highlighting: female investors—whose wealth levels have increased significantly owing to their success as corporate executives and entrepreneurs, in addition to inheritances and legal settlements—and millennials (people born between 1980 and 2000), whose overall wealth accumulation is rising steadily.

Our surveys of both wealth managers and wealth-management clients helped us analyze the exact nature of these two underserved segments. Broadly speaking, the wealth-management needs of these two groups fall more into a behavioral construct than one based purely on wealth level. Although segmentation based on wealth still has its place—UHNW investors will always have different needs than the affluent segment, for example—banks need to extend their current segmentation to include the behavioral axis as an important step toward understanding and addressing the needs of not only these emerging nontraditional segments but also the resulting combinations, such as UHNW women, affluent millennials, and UHNW millennials. Female millennials in particular represent an opportunity for wealth managers willing to customize their offerings to a high degree. Wealth managers must define and deliver tailored value propositions that are appropriate for both the wealth band *and* behavioral characteristics of their clients.

EXHIBIT 7 | Most Wealth Managers Base Client Segments on Wealth Level, but Service Models Remain Fairly Uniform

Source: BCG Wealth Manager Performance Databases, 2015 and 2016.

Female Investors

In 2015, women held an estimated 30% of global private wealth, with the share slightly higher in developed markets than in emerging ones. Their wealth, which is expected to grow by 7% annually (slightly above the global average) is increasingly self-generated, although much of it also originates from both inheritances and legal settlements. Efforts to target women in a concentrated and engaging way continue to lag among wealth managers. Indeed, only 14% of our wealth-manager survey respondents said that they had conducted some degree of marketing (such as seminars, events, or forums) directed at current or prospective female clients in the past year, and only 2% said that they actually considered women to be a specific client segment and had adapted their service model accordingly—such as by dedicating specifically trained RMs to women.

In our view, the key to answering the question of what women want in wealth management, and to delivering what is required, lies not in gender-specific products but in discovering women's true investment needs (especially those that are presently unmet), developing the right service models, and marketing those capabilities efficiently and effectively. Our survey found that female investors' needs are diluted when they are allocated to segments solely on the basis of wealth level, leading to dissatisfaction and ultimately to switching. Roughly 65% of our female survey respondents who had switched wealth managers reported doing so because of unhappiness with customer service and feeling misunderstood.

Female investors have unique needs across the entire value chain, particularly in their reasons for choosing a bank, in how they approach making investment decisions, in the

investment objectives they pursue, and in how they interact with their banks. According to our survey, 44% of women depend highly on referrals from trusted people in their environment when choosing a bank or wealth manager. More than 30% of female respondents listed friends and family as their primary source of investment advice (compared with 11% of all respondents), and just 10% of women listed their RM as the top source. This finding suggests that banks should invest in training RMs to create better, more productive connections with their female clients. In the same vein, more than 50% of women surveyed strongly agreed that they wanted their RM to know them on a personalized level, and more than 40% strongly agreed that they would like to see marketing campaigns that featured people like themselves and that discussed challenges similar to those that they face. A bank's track record of stability was also key to 55% of respondents, more than twice as important as the range of products provided (26%).

Many banks are losing female clients because service models lack the required level of customization.

Many banks are losing female clients because their service models lack the required level of customization across the value chain. In order both to repair the damage and to profit from the opportunity, banks need to further develop client insights (such as through smart analytics and reaching out to current and potential female customers) and adapt their value propositions accordingly.

Millennials

In contrast to the female investor segment, many millennials are not yet wealth management clients even though the segment holds an estimated 10% of global private wealth. As these young professionals, entrepreneurs, and inheritors significantly increase their wealth—at a 16% estimated annual growth rate, reaching 16% of global private wealth in 2020—it is imperative for wealth managers to understand and address their needs and to position themselves as the ideal partner.

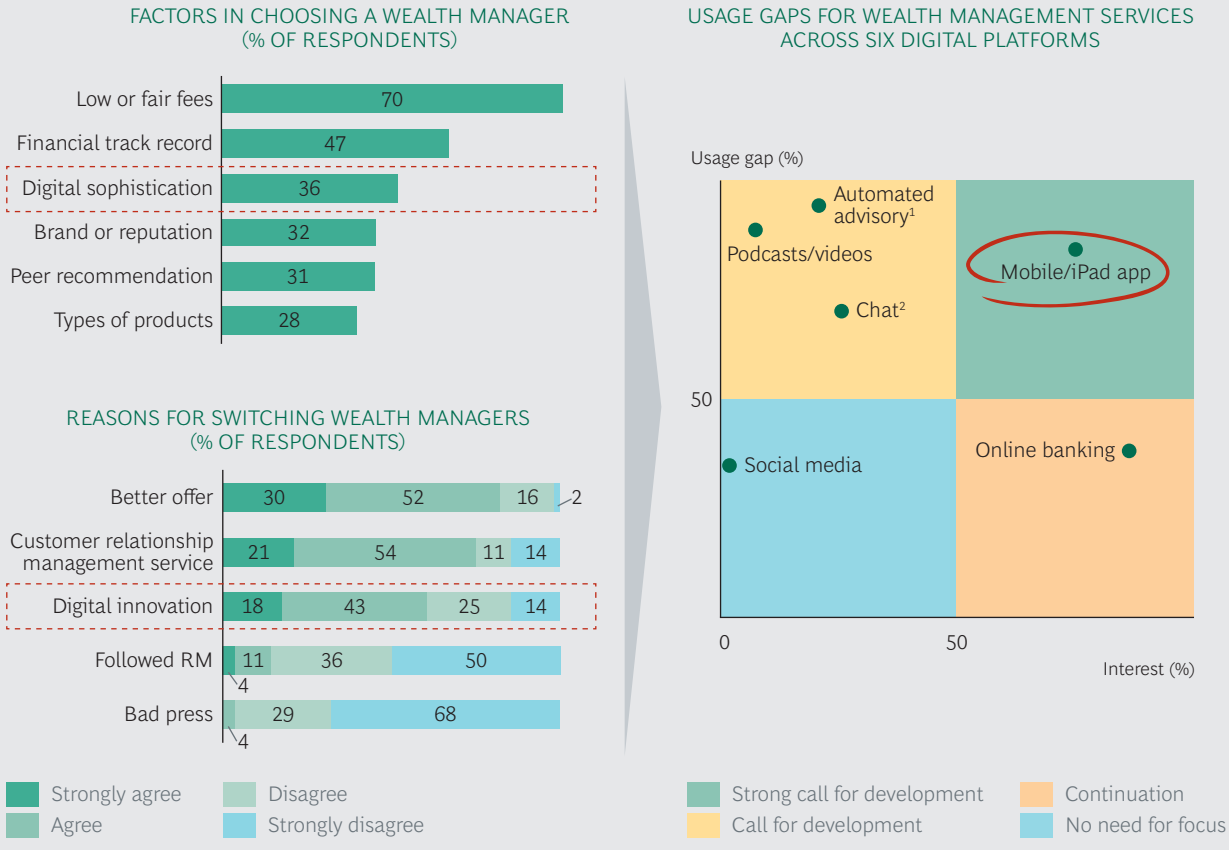
Fully 50% of the wealth managers we surveyed did not possess a clear view on how to address millennials in terms of service model, products, and overall approach. Not surprisingly, roughly 75% of millennial survey respondents who had switched banks said that dissatisfaction with customer service was the main reason. Millennials express specific needs that are not addressed by a segmentation approach that is based purely on wealth level. Of key significance are competitive and transparent pricing schemes, the bank's financial track record, and the sophistication of the digital offering. (See Exhibit 8.)

While an enhanced digital offering is imperative for all wealth clients, millennials in particular have grown up in an era of rapidly advancing technology, and both their private and professional behavior has been shaped by platforms such as Google, Alibaba, and Facebook. They are constantly connected and are always aiming for the highest speed and quality of information transfer. The vast majority already use online banking and mobile apps with their retail banks, and they expect flawless digital delivery from their wealth managers that is of a higher order than what is typically sought by traditional segments.

Although select banks are meeting millennials' digital needs in some areas—such as transaction views, reporting, and execution—there is still a measurable mismatch in others. For example, millennials are keenly interested in receiving many services currently provided by their RM—such as investment recommendations and portfolio analysis—through a digital channel, including chat or automated advisory. It is critical that the digital offering be easily integrated into millennials' instantly updated, interconnected world.

Of course, going digital in the millennial segment does not mean that wealth managers should *replace* RMs with technology. Instead, they should identify the areas in which millennials consider the RM a "value add" and focus their efforts there. For example, only 6% of millennials said that they relied princi-

Exhibit 8 | For Millennials, Digital Excellence Is a Key Factor in Choosing and Switching Wealth Managers



Source: BCG Global Wealth Client Needs Survey, 2016.
Note: Results are based on a 2016 survey of Millennials (between 21 and 35 years old). Wealth management services include investment advice, execution services, portfolio management, and portfolio reporting. Usage gaps are calculated as the potential usage rate less the current usage rate, divided by the potential usage rate. Respondent percentages may not add to 100 because of rounding.
[1]Robo-advisors.
[2]Online and video chatting capability.

pally on RMs for investment advice, and most did not care if their RMs knew them on a personalized level. But millennials do rely on their RMs to learn about and better understand new products (63%). In addition, millennials are likely to rely on their RMs more heavily as their wealth accumulates and their investment strategies become more complex. Wealth managers must invest in building the next generation of talent in order to meet the growing expectations of their future clients.

According to our survey, millennials are highly sensitive to competitive and transparent pricing. Having lived through the 2007–2008 financial crisis as young people, they are perhaps more skeptical about the financial industry than previous generations, prompting them to seek full transparency on both management fees and investment performance, especially in the current low-return environment. In our survey, 70% of millennials chose pricing as their top criterion in choosing a financial institution. What's more, with globalization and the Internet allowing investors to easily compare all major banking players and seek the best offering in terms of value, tech-savvy millennials are inclined to do extensive research. Wealth managers will therefore be increasingly challenged to clearly define, articulate, and deliver a differentiating value proposition that provides clear value-added for this highly discerning segment—one that justifies the price for services received.

Furthermore, since millennials are often socially and professionally connected across different regions and cultures, they are fre-

quently marked by a wish to invest in socially responsible products. Nearly 70% of millennial survey respondents said that they would like to invest in such products, which include renewable energy indexes, microfinance, and conservation finance. This wish plays an important role in their choice of wealth manager as well (58% of millennials versus 44% for all respondents). Socially responsible investing therefore represents another opportunity for fast-moving wealth managers.

Overall, millennials represent a growing pool of prospective clients who are highly discriminating, skeptical, and inclined to carry out their own proactive research. Their needs in the areas of digital capabilities, transparency, and socially responsible products demonstrate their self-directed drive. In order to measure up to the demanding attitudes of this younger generation, wealth managers must ensure that their value propositions are "battle tested."

Ultimately, from a strategic viewpoint, segmentation approaches that are based mainly on wealth level and cost-to-serve models—both of which continue to be used by the majority of players—neglect what many clients are truly willing to pay for. Such approaches no longer allow wealth managers to capitalize on the full potential of the market. As new segments with needs related more to their client experience and behavioral preferences continue to grow, the flaws of the current approaches and models will become more visible. In order to succeed, wealth managers will need to adopt a more comprehensive client-centric approach, decide how to sensibly segment their current and prospective clients, clearly identify their clients' needs, and define value propositions accordingly. Some wealth managers have already embarked on this journey, partly by leveraging insights from big data—but for most the first step has yet to be taken.

FOR FURTHER READING

The Boston Consulting Group has published other reports and articles that may be of interest to senior financial executives. Recent examples include those listed here.

Banking on Digital Simplicity: Global Retail Banking 2016
A report by The Boston Consulting Group, May 2016

Corporate Treasury Insights 2016
A Focus by The Boston Consulting Group, May 2016

The Value Migration: Global Capital Markets 2016
A report by The Boston Consulting Group, May 2016

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NOTE TO THE READER

About the Authors

Brent Beardsley is a senior partner and managing director in the Chicago office of The Boston Consulting Group and the global leader of the asset and wealth management segment of the Financial Institutions practice. **Bruce Holley** is a senior partner and managing director in the firm's New York office and a topic expert for wealth management and private banking in the United States. **Mariam Jaafar** is a partner and managing director in BCG's Singapore office and leads the wealth management segment in Asia-Pacific. **Daniel Kessler** is a partner and managing director in the firm's Zurich office and the global leader of the wealth management segment. **Federico Muxi** is a partner and managing director in BCG's Buenos Aires office and leads the wealth management segment in Latin America. **Matthias Naumann** is a senior partner and managing director in the firm's Zurich office and leads the Financial Institutions practice in Switzerland. **Tjun Tang** is a senior partner and managing director in BCG's Hong Kong office and leads the Financial Institutions practice in Asia-Pacific. **André Xavier** is a senior partner and managing director in the firm's São Paulo office and leads the Financial Institutions practice in Brazil. **Anna Zakrzewski** is a partner and managing director in BCG's Zurich office and a global topic expert for wealth management in Europe, the Middle East, Latin America, and Africa.

Acknowledgments

For their valuable contributions to the conception and development of this report, our special thanks go to the following BCG colleagues, by region.

Asia-Pacific and Japan: Federico Burgoni, Masahide Ohira, Sam Stewart, and Yasuhiro Yamai.

Europe: Peter Adams, Carlos Barradas, Thorsten Brackert, Maxim Ermilov, Erik Floor, Dean Frankle, Gustav Gotteberg, Luís Gravito, Max Hauser, Christophe Hamal, Krisztián Horváth, Sergey Ishkov, Til Klein, Ludger Kübel-Sorger, Benoît Macé, Martin Mende, Tim Monger, Edoardo Palmisani, Holger Sachse, Joël Schüepp, Akin Soysal, Burak Tansan, Ian Walsh, Jens Wergeni, Thomas Widmer, and Oktawian Zając.

Middle East and Africa: Reinhold Leichtfuss and Markus Massi.

Americas: Jorge Becerra, Kilian Berz, Nan DasGupta, Joel Muñiz, Galina Oleynik, and Jean-Werner de T'Serclaes.

Core consulting/project team: Freya Jenkins, Max Meulemann, David Oehri, Matthieu Regli, Philipp Rehbock, and Simon Ullrich, as well as the Global Wealth analyst team of Bruno Bacchetti, Amit Kamra, Nisha Mittal, Blaine Slack, Kalika Vashistha, Allison Xu, and Annette Pazur (benchmarking lead).

Special appreciation goes to Jürgen Rogg, leader of digital banking Europe and leader of the Technology Advantage practice in Switzerland, for his views on the digital acceleration and operations topics throughout the report.

We also thank the team from BCG's independent subsidiary Expand Research—Raza Hussain, Chad Jennings, and Amy Tsui Luke—for their contributions.

Finally, this publication would not have been possible without Philip Crawford's editorial direction, as well as the contributions of other members of the editorial and production team, including Katherine Andrews, Gary Callahan, Kim Friedman, Abby Garland, Hannah Holbrook, Sara Strassenreiter, and Janice Willett.

For Further Contact

Brent Beardsley
Senior Partner and Managing Director
BCG Chicago
+1 312 993 3300
beardsley.brent@bcg.com

Bruce Holley
Senior Partner and Managing Director
BCG New York
+1 212 446 2800
holley.bruce@bcg.com

Mariam Jaafar
Partner and Managing Director
BCG Singapore
+65 6429 2500
jaafar.mariam@bcg.com

Daniel Kessler
Partner and Managing Director
BCG Zurich
+41 44 388 86 66
kessler.daniel@bcg.com

Federico Muxi
Partner and Managing Director
BCG Buenos Aires
+54 11 4317 5900
muxi.federico@bcg.com

Matthias Naumann
Senior Partner and Managing Director
BCG Zurich
+41 44 388 86 66
naumann.matthias@bcg.com

Tjun Tang
Senior Partner and Managing Director
BCG Hong Kong
+852 2506 2111
tang.tjun@bcg.com

André Xavier
Senior Partner and Managing Director
BCG São Paulo
+55 11 3046 3533
xavier.andre@bcg.com

Anna Zakrzewski
Partner and Managing Director
BCG Zurich
+41 44 388 86 66
zakrzewski.anna@bcg.com

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