1 November 2010

Research Institute

Thought leadership from Credit Suisse Research
and the world's foremost experts

Global Wealth Report – implications for the Banking sector

Future focus on premier clients:
The next decade belongs to middle class growth in EMs

Global Banking – The next decade belongs to middle class growth in emerging markets

- Emerging banking and especially the fast-growing upper middle class in APAC, China and Latin America are the areas to focus on for international banks in search of profitable growth.
- Demographics (an aging USA/Europe/Japan and the younger population in APAC, India, Latam) will be the key driver in the decades to come.
- Ultra high net worth (UNHWI) and high net worth (HNWI) client segments are increasingly overbanked, resulting in further margin pressure for this particular client group.
- Technology-driven mobile banking strongly underpins emerging market wealth growth, but is itself not a profitable banking opportunity.
- Risks: Market access restrictions and protectionism, foreign exchange volatility, legal issues, and global funding issues.

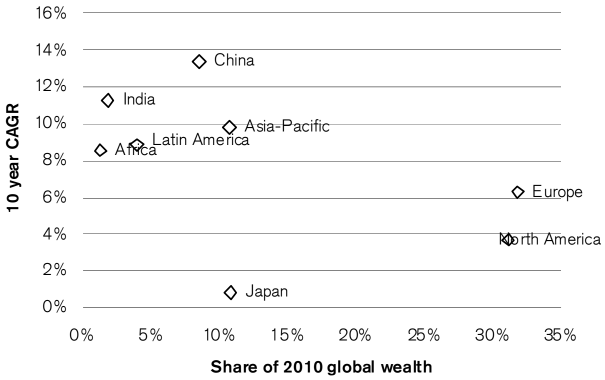
Implications of changing world wealth for the banking sector globally

In response to the increasing maturity of the wealth management and private banking industries in developed markets, many firms have announced their intention to focus on new franchises in emerging markets, particularly in Asia. Up until now, it has been difficult to quantify this opportunity or to assess different business models, as all that has been available has been individual company geographic revenue breakdowns (when disclosed) and anecdotal evidence. With the publication of the Credit Suisse Global Wealth Report, however, we have for the first time consistent and accurate data about the profile of wealth and investable assets in most of the world's key new markets.

Emerging markets stand out in comparison to the developed world in terms of their expected relatively higher economic growth and materially lower household debt levels, combined with a younger population. The fast growth and sheer size of the emerging consumer market and the growing banking client base are driving emerging banking, resulting in a multi-year structural growth potential that should generate a superior outlook for well-positioned financial institutions over the medium term.

Figure 1

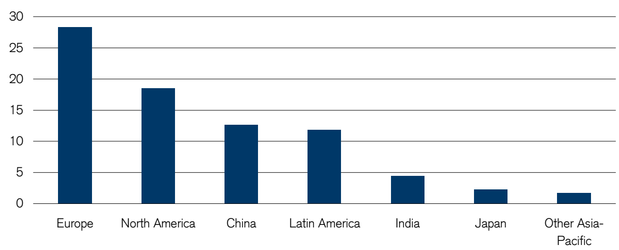
Global wealth and 10-year growth rates



Source: Credit Suisse Global Wealth Databook, Shorrocks/Davies/Lluberas

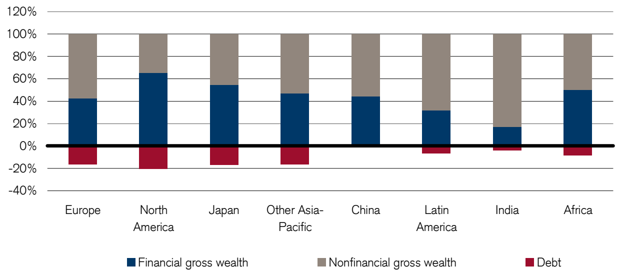
Figure 2

Incremental wealth creation in 2000–2010 (in USD trn, current market rates)



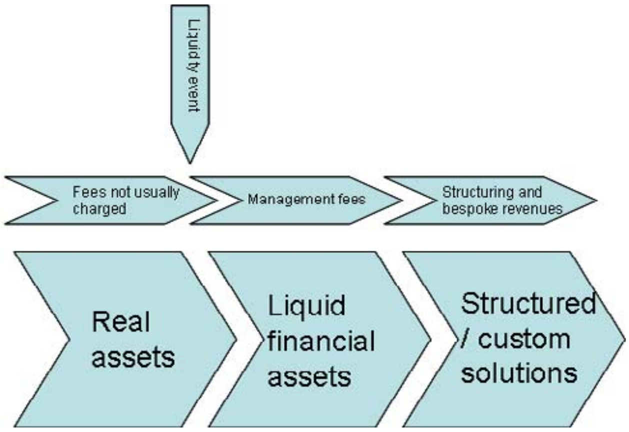
Source: Credit Suisse Global Wealth Databook, Shorrocks/Davies/Lluberas

Figure 3
Composition of wealth by asset type, % of total gross wealth



Source: Credit Suisse Global Wealth Databook, Shorrocks/Davies/Lluberas

Figure 4
Wealth management value chain



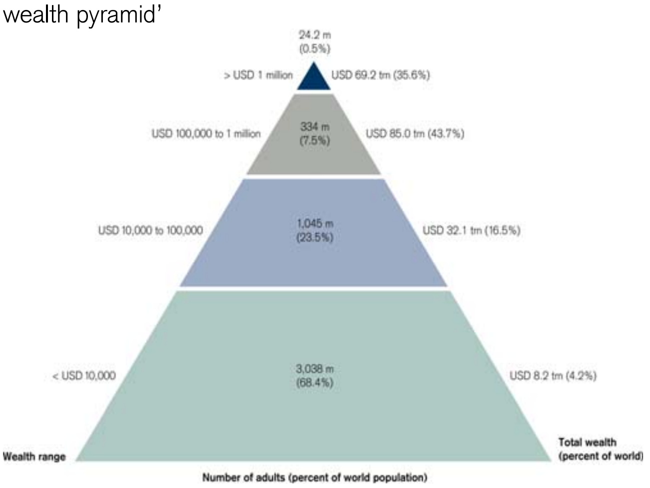
Source: Credit Suisse estimates

Leaving aside Japan as an outlier, the scatter plot in Figure 1 splits neatly into two groups: the large, mature markets of Europe and North America (which between them account for 63% of global wealth), and the emerging wealth markets with much higher growth rates. Looking at the incremental wealth created over the last ten years (see Figure 2), we see that other Asia-Pacific, India and China have created more new wealth than North America, and the emerging markets as a group have created more than Europe.

The nature of the opportunity for the financial services and wealth management industries can be seen further by looking at the breakdown into financial and non-financial wealth (see Figure 3), and by bringing debt into the picture. It can be seen that, in general, the fastest-growing wealth markets still have a significantly lower proportion of their wealth in the form of financial assets as opposed to property or industrial assets. The growth markets also have significantly lower levels of debt. Above all, this underlines the need for financial system development as an enabler of wealth growth. More lending and deeper debt markets are important enablers of wealth, while financial market development allows wealth to be crystallized.

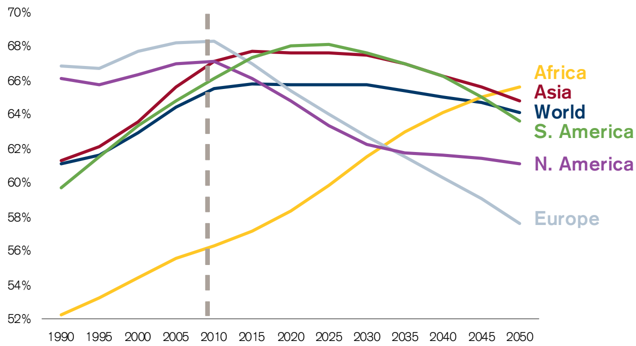
The composition of assets also matters, given the value chain of wealth management, at least as far as banking is concerned. As long as wealth is held in non-financial forms (i.e. largely property), it does not form part of the global fee base for the wealth management industry. The conversion of industrial wealth to financial wealth via IPOs or other liquidity events will generate

Figure 5
The global wealth pyramid: 1 billion adults in the 'middle of the wealth pyramid'



Source: Credit Suisse Global Wealth Databook, Shorrocks/Davies/Lluberas

Figure 6
Europe's fast-shrinking working age population limits wealth growth



Source: UN population projection 2008 income for the banking industry (see Figure 4), but this kind of transaction is concentrated at the UHNWI end of the market, a segment which we believe to be more or less saturated.

The main route by which emerging markets become more profitable, therefore, is by a gradual process of evolution in the underlying wealth portfolios, progressing largely by generational change and inheritance (which tends to result in nonfinancial assets being liquidated) and by the gradual accumulation of financial savings. There is little that can actively be done to accelerate this process, and so the wealth management opportunity would seem to be greatest in those markets where growth has already been seen in financial wealth and where the market is supported by saving out of income into financial assets. Once again, Figure 3 suggests that Asia and the emerging upper middle class are the key near-term opportunities.

In our view, the emerging upper middle class stands out in terms of future earnings growth potential for the banking industry. The Global Wealth Databook already estimates that there are 334 million adults in this segment (see Figure 5) and, in our opinion, economic development is likely to increase this number significantly. As Figures 6 and 7 show, there is a sharp contrast in demographics between the emerging markets and the current key wealth management geographies.

A changing profile of wealth and savings will require corresponding changes to the business models of financial service firms. While long-term projections are always difficult, we can identify a small number of key trends that are supported by the demographic data.

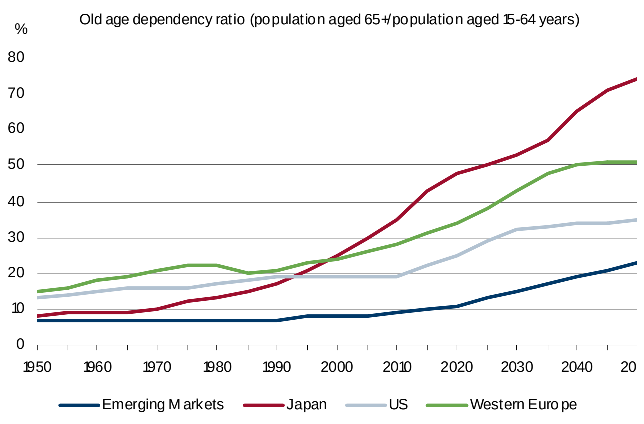
Key trends in emerging banking

- Technology-driven banking access: Mobile banking for the billions of poor allowing for faster overall domestic growth. Per se mobile banking and payment services are not a profitable business for banks, but allow for faster middle class growth.
- Banking growth driven by wealth development: The global distribution of “upper” affluent clients is shifting east while Europe continues to lose (see Figure 9).
- HNWI/UHNWI segment growth: Clearly the ultra high net worth segment is profiting but it starts to be overbanked given all the houses offering service and as a result margins are not only due to pricing power lower, but further squeezed by competition.

The emerging middle class – the sweet spot

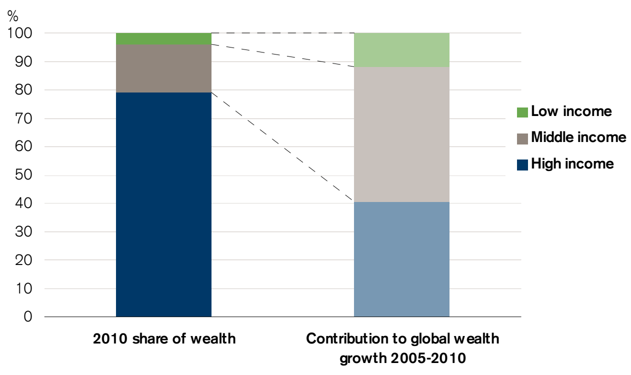
Up until now, the hunt for growth in banking has been focused on APAC, China and Latin America, with growing signs of interest in Africa recently. Because of a perceived need to show

Figure 7
Younger EM population as key driver for the next decades



Source: UN population projection 2008

Figure 8
Share of wealth by country income group and contribution to growth



Source: Credit Suisse Global Wealth Databook, Shorrocks/Davies/Lluberas fast growth in net new assets, banks have focused on ultra high net worth (UNHWI) and high net worth (HNWI) clients, a segment that has grown rapidly, but which is ultimately limited. As highlighted before and now underpinned by the Credit Suisse Global Wealth Report, the emerging middle class is a key sector to focus on in future (see Figures 8 and 9).

Demographic trends favor the EM middle class

In our view, the natural driver behind the current global growth distribution is the demographic trend with an aging population in the USA, Europe and Japan, while a younger population in emerging or already emerged markets drives consumption and growth. The working age population is shrinking fast in Europe, but also in the USA (see Figure 6). As a result, capital preservation is the focus. This could have implications for risks taken by investors and affect the overall economy negatively. In contrast, growth in emerging markets or emerged markets is well supported by the younger population (see Figure 7).

Retail banking products, such as bank accounts, credit cards, payment cards, consumer loans and mortgages will be widely sold. As emerging market clients are generally more positively attuned to investing, we expect safe-keeping accounts to grow quickly once the deposit size allows for investing. Figure 10 highlights the underpenetrated banking markets and how developed markets face saturation.

Technology and the mass affluent segment

For the last ten years, the global private banking industry's main priority in emerging markets has been driven by UHNWIs and by capturing wealth generated by the monetization of industrial wealth through IPOs. While this is likely to continue to be an important feature of the market, we think the UHNWI sector is close to saturation in terms of the number of institutions dedicated to serving it, and the generation of net new money in this way is highly dependent on the state of equity markets. Serving the decile immediately below the top will require a significantly different business model from the kind of activities that have generated net new money growth in the recent past.

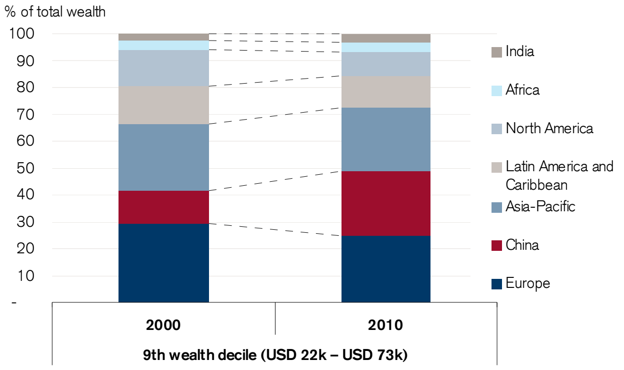
The last time the global wealth management industry concentrated on the "mass affluent" segment was during the dot-com boom in 1998–2001, and it was not a success, in our opinion. Of the major brands launched during this time, many no longer exist in their original form and only a few can really be called financial success stories. There are a number of reasons why this was the case, in our opinion: the technology was not really up to the demands made on it (particularly for mobile operations), the product offerings were too equity-focused and there was little attempt to adapt the business model to local conditions from the original US discount brokerage structure.

However, time and technology have moved on, and local financial product markets have become more sophisticated in a number of key markets. Increased take-up of mobile technology and internet access may have made the mass distribution of wealth management products via online channels more viable, significantly improving the profitability of this franchise by reducing distribution costs and commissions.

Local and global players

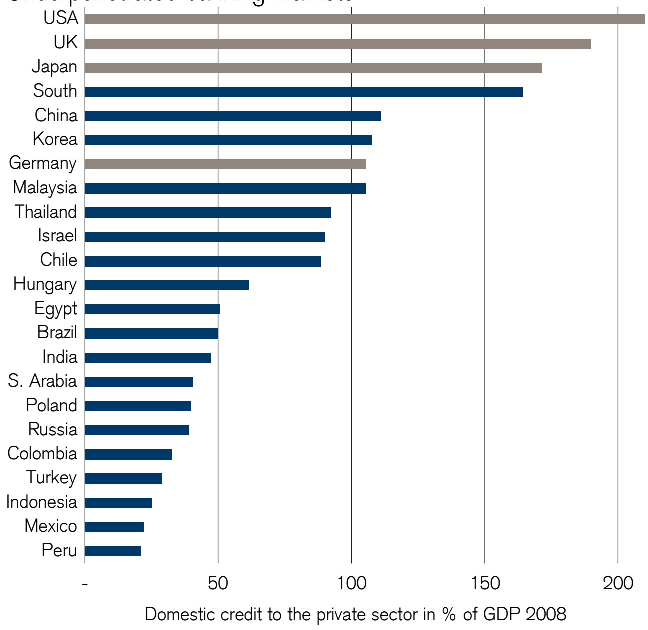
Since the emerging middle class are more or less by definition an onshore market, global wealth managers face material regulatory barriers in serving them. Local authorizations are needed for the distribution of any kind of savings product, while the integrated product offering we have identified as the key to value generation might in many cases require a full banking license – authorizations of this kind can be difficult and costly to acquire. In many cases, partnering with

Figure 9
Wealth share by country for middle of wealth pyramid 'owners'



Source: Credit Suisse Global Wealth Databook, Shorrocks/Davies/Lluberas

Figure 10
Underpenetrated banking markets



Source: World Bank, Credit Suisse

local firms through joint ventures or distribution agreements may end up being the best way to reach the market in question.

The key brand advantages of the established wealth managers remain the same in this context: financial and political stability, and product range and expertise. For most countries in the modern, post-capital-controls world, it ought to be possible to service mass affluent clients from an offshore-based platform; within that platform, a greater variety of investment products and solutions can be offered than those available from local domestic competitors. Global wealth management players are also more able to make investments in online delivery channels, amortizing the fixed cost of development over a number of geographies.

Bearing these trends in mind, we expect the domestic banking industry including selected “perceived” local institutions to initially benefit the most.

Latin America is different. The market access for foreign banks is widely granted and has grown historically. This is most visible in Mexico, where foreign institutions, mostly Spanish houses, control two thirds of the banking market.

Up to two thirds of Eastern European banking markets are controlled by western European banks. Several European banks are faced with a very limited market share and need to either grow or divest. Thus, we expect consolidation to continue, resulting in more profitable CEE franchises in the longer term.

Africa lacks size, i.e. the wealth created over the last ten years is yet not sufficient enough to focus on for profitable upper retail banking growth. Nevertheless, depending on further global economic growth, selected African countries might become more attractive banking markets in the longer term. Given current links to China – the involvement of Chinese banks cannot be ruled out.

The global wealth management industry is most directly affected by the trends identified in the Credit Suisse Global Wealth Report. The data clearly demonstrates that the center of gravity of the wealth management customer base is moving east and becoming more female, while the greatest new opportunities are likely to be seen further down the wealth pyramid, rather than concentrated in the UHNWI segment. Each of these trends will require significant adaptation to business models in order to address the new emerging middle class customer base and to benefit from growth opportunities.

Imprint

Publisher
Credit Suisse Group AG
Credit Suisse Research Institute
Paradeplatz 8
CH-8070 Zurich
Switzerland

For more information, please contact:
Michael O'Sullivan, Head of UK Research and Portfolio Analysis at Credit Suisse Private Banking
michael.o'sullivan@credit-suisse.com

Richard Kersley, Head of Equity Research Europe Product at Credit Suisse Investment Banking
richard.kersley@credit-suisse.com

Responsible authors
Daniel Davies
Christine Schmid

Editorial deadline
1 November 2010

General disclaimer / Important information

This document was produced for information purposes and for the use of the recipient. It does not constitute an offer or an invitation by or on behalf of Credit Suisse to any person to buy or sell any security. Nothing in this material constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to your individual circumstances, or otherwise constitutes a personal recommendation to you. The price and value of investments mentioned and any income that might accrue may fluctuate and may fall or rise. Any reference to past performance is not a guide to the future. The information and analysis contained in this publication have been compiled or arrived at from sources believed to be reliable but Credit Suisse does not make any representation as to their accuracy or completeness and does not accept liability for any loss arising from the use hereof. A Credit Suisse Group company may have acted upon the information and analysis contained in this publication before being made available to clients of Credit Suisse. Investments in emerging markets are speculative and considerably more volatile than investments in established markets. Some of the main risks are political risks, economic risks, credit risks, currency risks and market risks. Investments in foreign currencies are subject to exchange rate fluctuations. Before entering into any transaction, you should consider the suitability of the transaction to your particular circumstances and independently review (with your professional advisers as necessary) the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences. This document is issued and distributed in the United States by Credit Suisse Securities (USA) LL C, a U.S. registered broker-dealer; in Canada by Credit Suisse Securities (Canada), Inc.; and in Brazil by Banco de Investimentos Credit Suisse (Brasil) S.A. This document is distributed in Switzerland by Credit Suisse, a Swiss bank. Credit Suisse is authorized and regulated by the Swiss Financial Market Supervisory Authority (FINMA). This document is issued and distributed in Europe (except Switzerland) by Credit Suisse (UK) Limited and Credit Suisse Securities (Europe) Limited, London. Credit Suisse Securities (Europe) Limited, London and Credit Suisse (UK) Limited, both authorized and regulated by the Financial Services Authority, are associated but independent legal and regulated entities within the Credit Suisse. The protections made available by the UK's Financial Services Authority for private customers do not apply to investments or services provided by a person outside the UK, nor will the Financial Services Compensation Scheme be available if the issuer of the investment fails to meet its obligations. This document has been issued in Asia-Pacific by whichever of the following is the appropriately authorized entity of the relevant jurisdiction: in Hong Kong by Credit Suisse (Hong Kong) Limited, a corporation licensed with the Hong Kong Securities and Futures Commission or Credit Suisse Hong Kong branch, an Authorized Institution regulated by the Hong Kong Monetary Authority and a Registered Institution regulated by the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong); in Japan by Credit Suisse Securities (Japan) Limited; elsewhere in Asia-Pacific by whichever of the following is the appropriately authorized entity in the relevant jurisdiction: Credit Suisse Equities (Australia) Limited, Credit Suisse Securities (Thailand) Limited, Credit Suisse Securities (Malaysia) Sdn Bhd, Credit Suisse Singapore Branch and elsewhere in the world by the relevant authorized affiliate of the above.