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OLIVER WYMAN

BLUEPAPER

Asset Managers & Wholesale Banks

Searching for Growth in an Age of Disruption

Fees are under pressure faster than market expected – is asset management no longer a growth sector? C-Suite must define a growth agenda to regain stock multiple. For alpha growth, look to China and Alts. Wholesale banks must restructure and find growth. Winners skewed to US and Asia.

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Executive Summary

- *Asset managers and wholesale banks are under increasing investor pressure to accelerate growth while managing down costs. Yet both are facing falling margins and a market environment that is disappointing relative to expectations.*

- *Asset managers need to respond to the commoditization of market / benchmark returns caused by passive, and the knock-on impact of this shift in market structure on sell-side revenues demands that wholesale banks, in turn, find cheaper ways to serve their investor client base and seek growth elsewhere.*

- *The race is on to launch new propositions for clients and gain share by addressing emerging client needs and combat disruption from new entrants. But this must be accompanied by an aggressive focus on the bottom line. While costs can be high, more possibilities now exist to restructure consistently challenged businesses.*

- *Management in both industries need to decide their strategy in China as markets open up. The growing pool of externally managed AUM is an opportunity for foreign asset managers, and over the long term this will drive an expansion of the investor wallet for the sell-side.*

- *In the battle to adapt and leverage new technologies, established firms with the capital to reinvest as well as new entrants are seeking opportunities to quickly outcompete slow-moving incumbents. Winners will leverage their data advantage in providing new client solutions. Investment is ramping up in both industries. Both incremental and greenfield builds should be considered.*

- *Fundamental shifts in market structure and client behaviour mean that firms with the weakest starting point are increasingly disadvantaged. They will have to balance competing demands to defend core markets with the need to follow the money and find long-term growth. The cost of catching up is increasing.*

Priorities for the C-Suite

Asset Managers

1. **Set an ambitious but credible growth agenda** that can help change perception and differentiate, allowing investors to reward those with growth prospects. Our base case sees industry revenues growing at only ~1% annually over the coming 5 years as (perceived) commoditization asserts downward pricing pressure.

2. **Chart a course for emerging Asia, Private Markets and Solutions.** These businesses will grow to >50% of global revenue pool in 5 years. Regulatory driven change is pushing Asia to the fore, with onshore China driving 50% of emerging market client revenue growth. Private market AUM set to grow at 10% annually as the mix of public-to-private capital raising shifts and investors address under-allocation. The solutions sector will see asset managers leverage data technology advancement to create new value through redefining relationships with, and services to, investors.

3. **Restructure the core active business** as the revenue pool is set to shrink at ~9% annually. Redefine (and demonstrate) the active proposition and be ready to compete at a lower price point; plan to take out 30% of core costs, which will be critical to fund growth and ensure survival in core active. Examine greenfield builds as an alternative to traditional approaches to IT replacement, radically reducing the number of legacy systems.

Wholesale Banks

1. **Shift resources to follow the money.** Be an early mover in one or more growth markets, such as China and corporate clients, or develop new solutions for institutional clients to overcome headwinds in that sector. It will take time for investments to deliver, but the cost of catching up will accelerate as winning franchises are able to leverage scalable operating models and digital platforms to gain share.

2. **Target legacy to get more efficient.** Technology can be a double-edged sword, lowering margins and costs. Invest to maximize efficiencies. Tackle service provider costs to unlock more than twice the savings that are achievable through front office cuts alone, and simultaneously increase the flexibility to pursue strategic exits.

3. **Leverage tech and data to rethink business models.** Fight hard to defend profitable businesses that are at risk of disruption from entrants, such as cash management, and invest in technologies to rebase costs. For some, more radical business model shifts including partnership models and elements of creative capitulation in flow trading can reduce the drag of businesses where there is little chance of success.

Asset Managers

The Asset Management industry stands at a critical junction. Structural pressures are set to intensify for the core active business, yet we see an alternative path to attractive pockets of growth in EM/China, private markets and solutions for firms. For these areas, firms must be able to afford the requisite investments over a multi-year horizon and have the capabilities to compete in areas of significantly higher complexity to their "core".

2018 saw asset management equity market valuations fall to a 20-year low as concerns on forward looking growth intensified. The industry needs to make a critical choice.

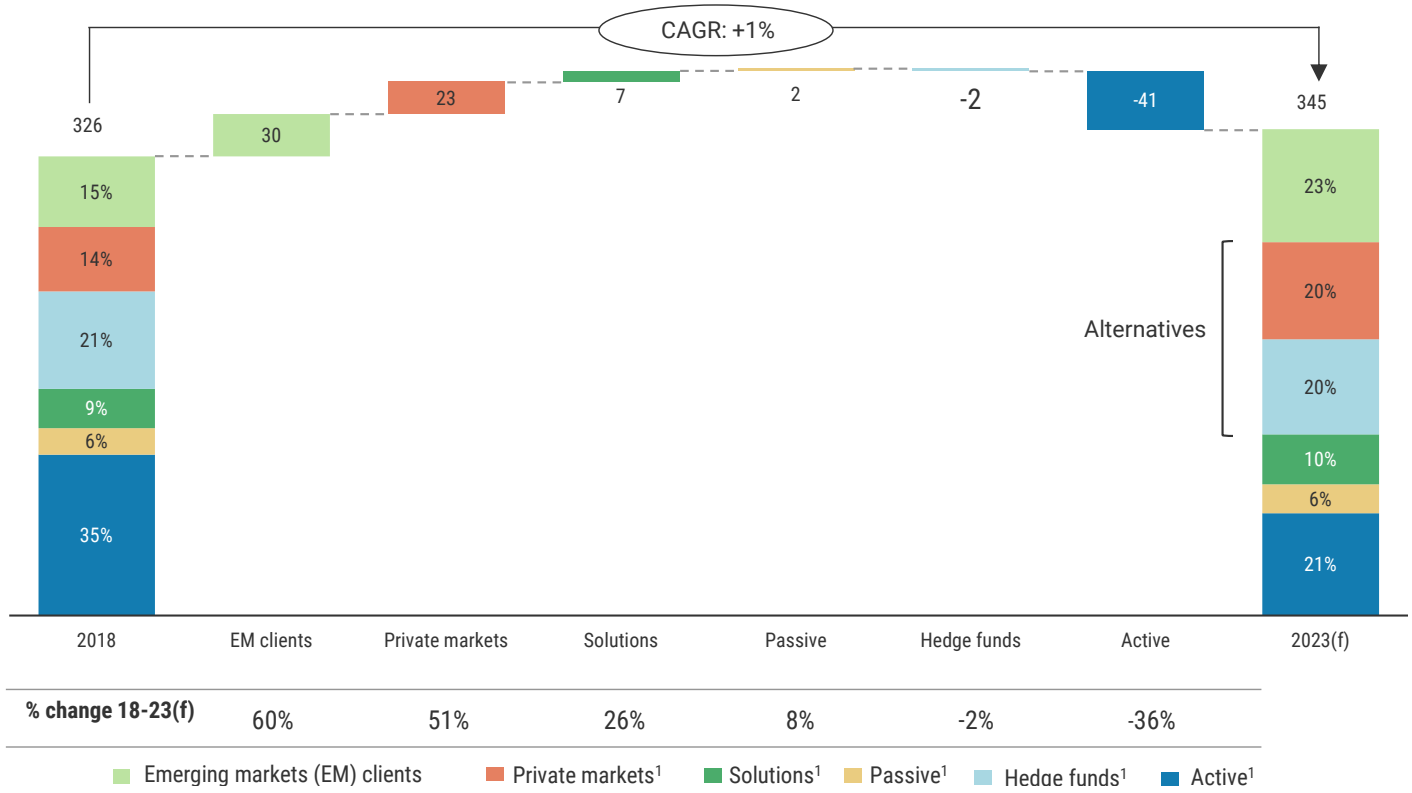
Over the last 5 years, industry revenues have grown at a 4% CAGR bolstered by asset value appreciation and inflows, reaching an all-time high of $326bn in 2018 with over $80tn of externally managed AUM at year end. But beneath these headline numbers, there is a growing unwillingness by investors to pay asset management fees.

Over the next 5 years, we forecast total asset management industry revenues will grow at just ~1% CAGR. Three growth zones – EM clients, private markets and solutions – will drive this, growing from 38% of the fee pool to 53% by 2023. On the flip side, the revenue pool of core active management in developed markets is set to shrink by over a third over this time and will no longer be the largest contributor to industry revenues. In passive, further growth in AUM share will be largely offset by ongoing price commoditization.

Exhibit 1:

In the next 5 years asset management revenue growth will slow down; however, three areas will see stronger growth and comprise over 50% of total revenue

Global revenue composition – Base case, 2018 – 2023(f), USD BN



1.Does not include EM clients
Source: Oliver Wyman analysis

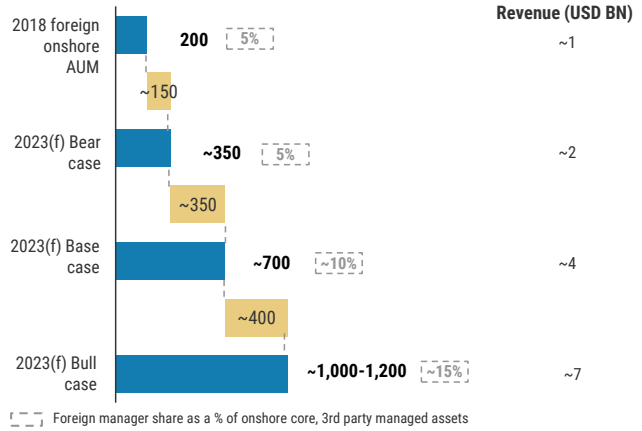
The growth in passive has commoditized access to market/benchmark returns. Until recently this trend was offset by growth in higher fee products at the aggressive end of the alpha spectrum, and strongly performing active managers could still expect good inflows as investors recycled mandates from weaker performers. This is changing. Investors are increasingly withdrawing allocations from active management altogether. While there are risks that stem from this shift to passive (including market concentration, liquidity, operational concerns and broader impact on market structure), the reality is that the premium charged for active asset management is falling steeply.

If the industry cannot redefine its value proposition into something that investors are willing to pay for, revenue growth prospects look weak, especially when the QE-driven cycle eventually comes to an end. Asset managers would be forced into a tight spiral of cost and capacity restructuring to maintain earnings.

Exhibit 2:

In a base case, we see roughly 10% market share for foreign managers by 2023 in onshore China

Scenarios for foreign asset manager share of onshore Chinese investor sourced AUM, 2018 vs 2023(f), USD BN



Source: Oliver Wyman analysis

To counter this, we see three zones where asset managers can build value and drive revenue growth:

- **Emerging Markets: Supporting capital market development represents a $30bn revenue growth opportunity – with China driving half of this.** Today, the bulk of foreign asset managers' emerging market client AUM is sourced from large public funds investing into Western markets. Looking forward, we think the growth opportunity will be more "local" in nature. To benefit from this, foreign asset managers will need more localized operating models. In China recent industry liberalization and the government-led push to strengthen domestic capital markets is adding to optimism among foreign asset managers.

- **Private Markets: Opening access to private markets through new and more efficient delivery models has the potential to drive an additional $23bn in revenue.** The growth in private capital markets has outstripped public markets but the investment into private markets continues to come from a subset of institutional client segments: defined benefit pensions, sovereign wealth funds and endowments. We expect the growth opportunity for asset managers will come from helping other segments, namely high net worth individuals, defined contribution pensions and insurers, to increase participation in private markets. Asset managers that can efficiently deliver products while working closely with policy makers and distributor platforms will find this opportunity more accessible.

- **Solutions: New technology is set to enable mass customization of solutions for a broader client group, opening up +$7bn of revenues.** The solutions space has been a bright growth spot for those with the required breadth of capabilities driven by structural and demographic shifts in pension markets. Outcome-oriented products have grown and increasing demand for flexible retirement solutions creates further opportunity. Rapid evolution in data management and automation is opening opportunities to bring customization to the mass market, and for asset managers to redefine their relationships with clients. The battle for this growth will not just be between asset managers, but also with technology players and distributors.

This outlook presents asset managers with two important strategic questions to answer:

1. how aggressively to defend the value of the core active business?

As with other industries that have undergone dramatic pricing pressure, asset managers need to decide whether to stay and fight in traditional active or to move away. Delaying has been an option so far, but decisions are coming to a head.

There are a number of steps active managers can take to defend the space including redefining the proposition around active ownership (e.g. taping into demands for shareholder stewardship); investing to help clients understand the risk in their portfolio; and reengineering both the cost base and fund delivery models to offer active management at a materially lower all-in, price. Not all will choose to invest, and we expect more consolidation in the core active market.

2. Where to build capacity in the growth zones, and how to pursue these?

Across each of the growth zones, there are different operating models that management need to choose between. For example:

- EM/China: Build distribution access vs. renting access through partnerships;
- Private markets: Build, acquire or source the required investment capability from other partners; and
- Solutions: Build or partner around client-facing technology – with a parallel challenge of building a transformative innovation culture alongside a traditional investment culture.

We expect that the most aggressive asset managers will be investing 5-10% of revenues to pursue growth. With industry operating margins already meaningfully lower than at this point in the previous cycle and uncertain economic conditions ahead, the industry needs to find radical reductions in the existing cost base to allow investment for growth. We see opportunities for the industry to cut up to 30% of the existing cost base through automation, outsourcing and rationalization.

However, little progress was made in 2018, with costs again rising materially above inflation and programs too often limited to tinkering at the edges. At the core of the operating model cost challenge is asset managers' failure to dictate data standards and tackling this should be a priority. Greater control of the data integration layer will give asset managers more flexibility to outsource and plug in service providers, to drive process automation, and to build new levels of customer understanding and experience. The experience from retail banking has been that adopting a greenfield approach to technology in a new, blank slate business model, can provide an attractive route to achieve this.

Wholesale Banks

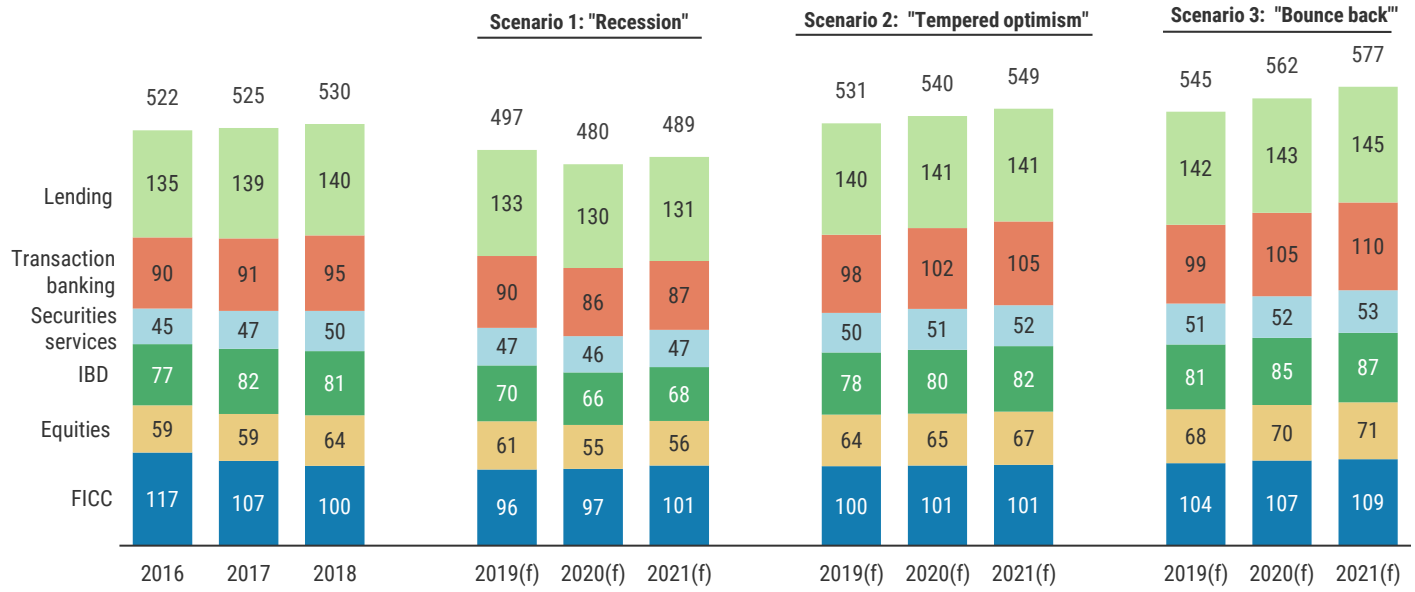
Wholesale banks need to restructure and find break-out growth solutions to combat weak underlying revenue growth. By mid-2018, there was a growing optimism that investment banks had weathered the worst, and expectations had converged around revenue growth of 3% CAGR. But the revenue outlook has weakened and 2019 has started slowly. This weaker revenue outlook will force Corporate and Investment Banks to further restructure businesses. We expect industry wide revenues to grow at only ~1% CAGR out to 2021, which will deliver only modest improvements in returns on equity (RoEs). The goal should be to starve uneconomic businesses and restructure operating models, while shifting resources to growth pockets.

Flow trading businesses are the most challenged. The existing economics are below the cost of capital for all but a few banks with scale in markets where they compete, and structural pressures on revenues from shifts in the buy-side and the emergence of non-bank players are compounding the pain. Leaders need to continue to invest in technology upgrades to retain an edge, whereas sub-scale franchises need to look for radical ways to restructure – either through exits, operating model reform, or through partnership models and strategies of creative capitulation that outsource front office activities to third parties (such as liquidity provision) to improve customer propositions and boost profitability.

Exhibit 3:

We estimate that Wholesale Banking revenues will grow at an annualized rate of ~1% in our central revenue scenario of "Tempered optimism"

Wholesale Banking industry revenue forecasts, 2016-2021(f), USD BN



Note: Only includes revenues from corporate clients with an annual turnover of over USD 1.5BN. FICC includes G10 Rates, G10 FX, Emerging markets, Commodities, Credit and Securitization. Equities includes Cash, Equity derivatives and Prime services. IBD includes DCM, ECM and M&A. Transaction banking includes Trade finance and Cash management.
Source: Oliver Wyman analysis, Coalition proprietary data, Morgan Stanley Research

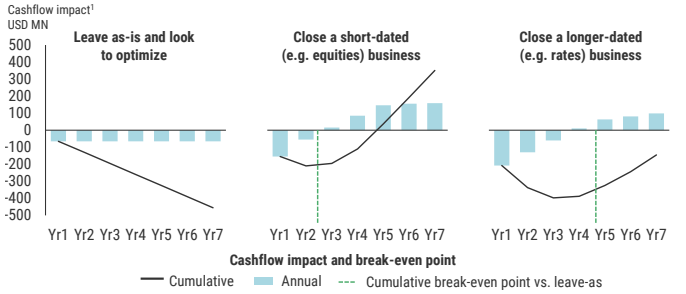
The embedded advantages that scale banks – particularly US leaders – enjoy today will cement their longer-term outperformance. Revenue pressures and the need to invest are mandating cost control, but their strong starting point, both in terms of scale and profitability, gives them the option of both expanding their footprint and defending existing leadership positions. Within this group, the biggest winners will be those that can expand their addressable market through low-marginal cost business models employing new technology. This will require deep pockets and a management team willing to maintain investment levels through the cycle.

Time to tackle service provider costs. Group cost reduction efforts have made the greatest progress in the front office. New regulations and concerns over reputational risk have meant that ballooning compliance demands have prevented real reductions in corporate center costs. This has acted as an anchor on current performance and, perhaps more importantly, has limited future strategic options. It is hard to exit a business if you cannot be sure costs will come down fairly quickly after revenues are lost. And it is typically allocated costs that are the stickiest. We estimate that a reduction in service provider costs will unlock more than twice the level of savings that are achievable through front office cuts alone.

Exhibit 4:

Exiting uneconomic businesses requires banks to get costs out faster

J-curve impacts of closing whole business lines, based on a business generating USD 500MN of revenues at 95% CIR



1. Cashflow impact based on revenue minus costs minus the cost of funding the balance sheet and other financial resources

Note: Assumes average cost of funding. Higher funding costs would bring forward the "break-even" point as releasing balance sheet would be more impactful. Cost modelled with an industry-average split between variable front office, aligned support function, and fixed Group costs. Tax impacts not included

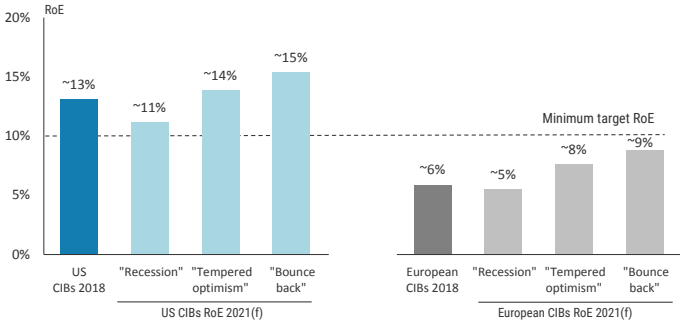
Source: Oliver Wyman analysis

Mid-sized global wholesale banks, particularly European banks, need to look at more radical options. Returns on equity are, on average, half that of their US rivals, and home markets are less profitable and shrinking. The weaker starting point, smaller technology budgets, and less attractive growth in domestic revenue pools will drive a strategic focus to defend their strongest businesses, in many cases the corporate franchise, and to position in growth markets. To do this they will need to cut deeper in their weaker businesses and make bolder moves on innovation – including considering partnerships, exits and options to build greenfield platforms.

Exhibit 5:

US banks will consolidate their leadership positions

RoE for US and European banks, CIB divisions only, forecasts based on market growth for our three revenue outlook scenarios, and already announced cost savings programs (%) 2018-2021(f)



Note: Excludes the impact of any additional management action beyond what is already in flight
Source: Oliver Wyman analysis

It is decision time for foreign banks in China. Regulatory changes across both the buy-side and sell-side are leading to faster revenue growth in China, which we estimate at 7% CAGR for S&T and IBD alone out to 2021. This growth opportunity is becoming more accessible to foreign banks. Sustained commitment will require significant investments and it will take time to earn a return on these in the face of stiff competition from local banks, which are well placed to withstand low returns for longer than foreign banks can, to build on their existing strengths and to develop capabilities to compete with global banks.

The race is on to win with corporate clients. We expect revenues from corporate clients to grow at 4x the pace of institutional clients out to 2021, with transaction banking remaining the engine for growth at 4% CAGR. But operating models are inefficient and already starting to be undercut by new technologies. Disruptive new entrants will be able to improve customer propositions and outcompete on price to dislodge a greater share of revenues than had previously been accessible. As the competitive landscape shifts, early movers will gain an outsized share of the upside and develop highly scalable platforms. Global leaders and new entrants from both inside and outside the industry are best placed to capitalize.

Messages From Our Proprietary Survey With Asset Managers

Key takeaways from our meetings with senior executives of Asset Managers with ~$15tn of combined assets under management.

China

This time feels different. China is opening up...

- Executives expressed confidence that the Chinese government is committed to opening its financial services industry, regardless of trade tensions with the US. We should see some firms move towards 100% wholly owned subsidiaries in the near term.
- Firms we spoke to believe that government officials think efficient allocation of capital is a national requirement.
- Several executives highlighted that the MSCI index inclusion of China A shares will support growth in allocations to Chinese equities.
- Biggest opportunities could be in pensions and flows from digital distribution retail channels. Whilst by product, equities are under-penetrated and new licenses will allow sales of more private and alternative assets.

...with market structure and dynamics as a tailwind for active asset managers.

- Firms were mostly bullish on active management in China. Why? 1) The Chinese population doesn't appear to trust passive indices yet. 2) ETF pricing in China is similar to mutual fund pricing. 3) Inefficient market and a lack of strong corporate governance creates an opportunity for active managers to generate alpha.
- Regulations in China change rapidly, so asset managers need to be more nimble and flexible than in the US or Europe.
- The investor base is small, but growing. The pushback from some firms with low exposure to China is that the investor base is too small, with a population that is used to guaranteed returns, not risk-taking. These firms noted that gaining traction could be a multi-decade story.

The experience of foreign managers varies significantly, but it's what they do from here that matters.

- Does joint venture experience matter? We heard both sides of the argument. Some firms with JV experience in China noted that the government and industry relationships they have built took a long time to develop.
- Others, including firms with successful JVs, noted that the scale of new, untapped demand is so large and up for grabs that it's tough to tell which firms will win. Even 1% share gain by a foreign firm would be significant.
- Executives were however consistent in recognizing the advantages the JV partner brings in terms of distribution and exposure to mass market retail; though they were also cognizant this can limit their level of freedom and create a dependency on the partner – with potential to jeopardize the business if dynamics deteriorate.

Alternatives

Demand for alternatives is higher than supply.

- Some firms noted that most clients need alternatives in their portfolios. Inclusion of an illiquidity premium helps managers achieve objectives in various liability profiles and the illiquidity of the assets helps "lock in" revenues over a longer time horizon.
- Current demand is driven by broad-based investor types including pension funds, sovereign wealth funds, HNW investors, endowments, foundations and insurance, with wide ranges of current allocations to alternatives (from none at all to >40%).
- Private credit, real estate, infrastructure and energy were noted by executives as areas of growth.
- Moving into adjacencies (e.g. private credit, opportunistic real estate) or bolting-on capabilities were seen as the most plausible routes for traditional managers to access the opportunity set.
- Attracting the best talent, fostering the appropriate culture, and developing origination and distributions capabilities will be key to the success of asset managers in the alternatives space.

Retail demand is on the horizon, but it will be a slower story.

- Potential regulatory change is increasing the probability that alternatives could be sold into the mass market.
- Whilst timing is uncertain, there is growing confidence that the benefits of alternatives can no longer be ignored especially for defined contribution portfolios that have a longer investment time horizon.
- Some firms have teams actively educating retail financial advisors.
- Others expressed concern that educating RIAs, FAs and HNW retail clients will take time while emphasizing there's a greater burden put on people to understand what they are investing in if they cannot trade out of it tomorrow.
- Product set would be required to have a smaller minimum to attract retail investors; need to think about creative ways to "package" these products for the retail investor.
- Not there yet in terms of people wanting to buy these strategies on their mobile phones.
- The near or medium-term retail opportunity is with private banks and wirehouses.

Outlook for liquid alternatives is not as strong as illiquid alternatives.

- Firms highlighted that a lot of their efforts rely on accessing the illiquidity premium.

We would like to thank the firms and individuals who took the time to meet with us.

Asset Managers: What's On Your Growth Agenda?

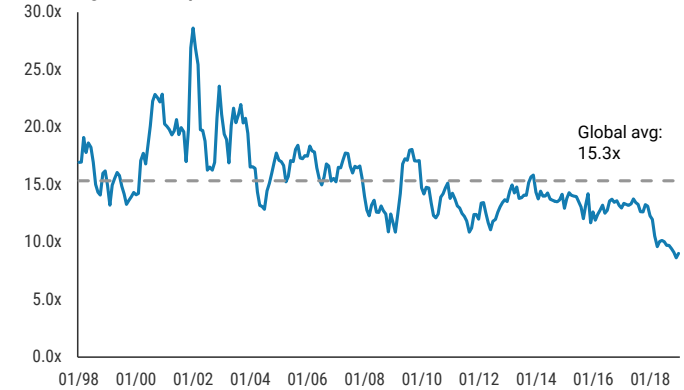
1. The expectations challenge

The 10-year bull cycle that started following the crisis has seen buoyant revenue growth for the asset management industry. However, this has begun to slow, and 2018 saw a major downturn in market expectations for continued revenue growth, with industry valuation multiples falling to a 20-year low. Underlying this is a growing concern about investors' willingness to pay the level of asset management fees that they historically have.

Exhibit 6:

Industry valuations have sold off despite stable earnings as growth prospects are pared back

Asset Manager P/E Multiples, 1998-2018



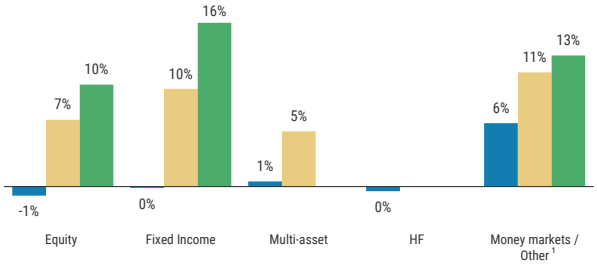
Source: Morgan Stanley Research

Passive asset management now accounts for over 25% of global AUM. 2018 saw another year of strong inflows into passive and ETF products, while active products struggled. Of note was the relative acceleration of growth in passive fixed income inflows.

Exhibit 7:

ETFs and passive products continue to gain share of AUM in public markets across all asset classes

Active vs passive net flows by asset class, % 2018 flows as a proportion of 2017 YE AUM



2018 AUM, USD TN					
Active	~18	~12	~6	~3	~11
Passive[2]	~14	~4	<0.5	-	<0.5
ETFs	~4	~1	<0.5	-	<0.5

Note: excludes. private markets (AUM ~USD 5TN)

1. Includes Money Markets (>80% of 'Other' category), Commodities, Property, Miscellaneous, and Unclassified data categories

2. Excl. ETFs

Source: Oliver Wyman analysis, Morningstar

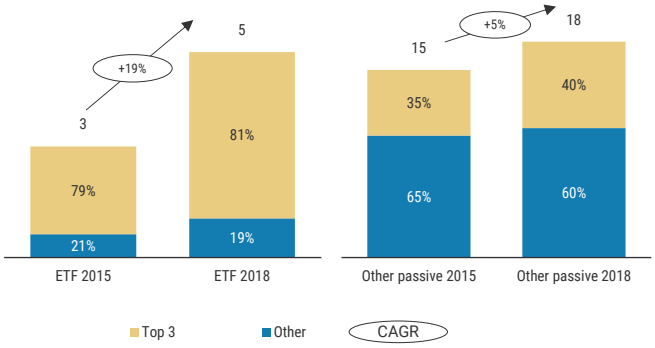
Historically, active managers with the strongest relative investment performance could expect to be rewarded with the lion's share of net inflows as investors switched managers (supported by the growth of open architecture and dissemination of performance rankings in retail distribution). But increasingly, it appears that investors with poorly performing products are switching out of active asset management altogether. In 2018 US retail funds saw active managers with top-performing funds just managing to hold onto net AUM while those who underperformed experienced heavy outflows. A similar trend is growing in Europe.

With the growth in passive, access to market / benchmark returns has become commoditized. The passive market is highly competitive, with average fees falling at 7% per year since 2015. While there are clear benefits of scale in passive, especially ETFs, new entrants are competing largely on price for market share.

Exhibit 8:

Price competition along with product innovation has allowed new entrants to compete in ETF markets

Share of top-3 Passive/ETF players, 2015 and 2018, % share, USD TN



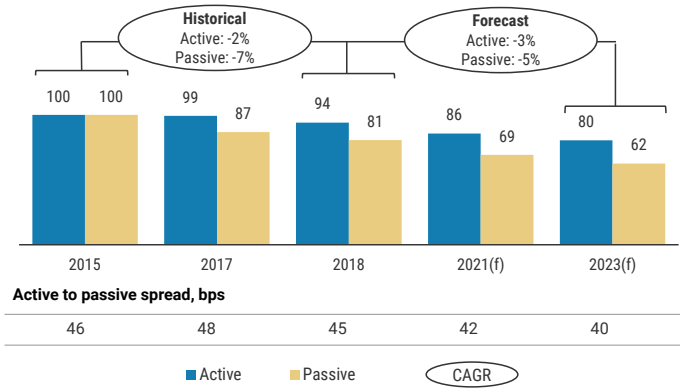
Source: Oliver Wyman analysis

In this environment it is increasingly difficult for active managers to defend their active pricing premium. In 2017 the spread between average active and passive fees hit a historical industry high. In 2018 this reversed slightly as active managers acted to defend market share and reduced active fees by almost 5%. The pressure was most acute in fixed income.

Exhibit 9:

Ongoing pressure on passive fees is working its way through into active pricing

Active and passive fees, 2015-2023(f), indexed to 2015 value, active to passive fee compression %



Source: Morningstar, Mercer Fee survey, Oliver Wyman analysis

Over the coming years, it is difficult to see how this fee pressure will abate in either passive or active management. As our base case, we expect pricing compression in active to increase to 3% per year (narrowing the spread between active and passive fees). Over the next 5 years, we expect the industry revenue pool for core active management in developed markets to drop by over a third.

Exhibit 10:

Active revenues in developed markets are projected to lose over 30% of their value as a result of outflows to passive and increasing fee compression

Compression of traditional active revenue in developed markets,2018-2023 (f) USD BN

Note: "Core active DM" excludes revenues from EM clients

Source: Oliver Wyman analysis

This pressure further feeds through into the aggregated outlook for industry revenue growth. Our base case is a modest 1% per annum growth over the next 3-5 years, with global industry revenues growing from $326bn in 2018 to $337bn by 2021 and $345bn by 2023. We see a bull-bear range around this growth forecast, -9% and 6% CAGR respectively. These scenarios reflect at the lower end, the industry being caught in the downward spiral of aggressive price competition in active management, possibly exacerbated by falling market values; and, at the upper end, a more benign environment both in terms of equity market performance and pricing pressure.

Exhibit 11:

We see three potential industry scenarios playing out over the next three years, driven by pricing behaviour as well as asset class performance

Scenarios for industry revenues, 2021(f), % change versus 2018

	Bear	Base	Bull
	Acceleration in margin pressure and product shift, with poor asset price performance	*Continuation of current margin / product shift trajectory; modest asset price performance*	*Slow-down in margin pressure and product mix shift; stronger asset price performance*
Industry YE AUM (USD TN, % change over 3 years)	~ USD 77TN -4%	~ USD 94TN 17%	~USD 101TN 25%
Fee pressure and product mix effects (% change over 3 years)	-20%	-13%	-6%
Revenue (USD BN, % change over 3 years)	**~USD 247BN** **-24%**	**~USD 337BN** **3%**	**~USD 388BN** **19%**

Source: Oliver Wyman analysis

Within our base case, we see three zones where asset managers can deliver value to investors and grow revenue faster:

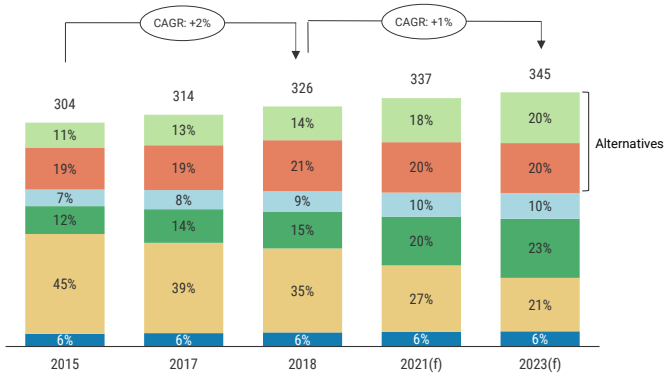
- EM clients: Support capital market development with growth in the emerging market client base - with China representing half this opportunity
- Private markets: Open access to private markets through new and more cost-efficient delivery models to investor segments that currently have low exposure to private markets
- Solutions: Apply data management technology to enable mass customization of solutions

We expect the revenue pools relating to these three zones to grow at an average 8% CAGR over the next 3-5 years and to grow from an aggregate 38% to over 50% of industry revenues. By 2023, we expect over 40% of industry revenues to come from alternatives, with private markets as the main driver of this growth. Passive will continue to take share of total AUM but its share of total revenues will remain flat due to further price competition.

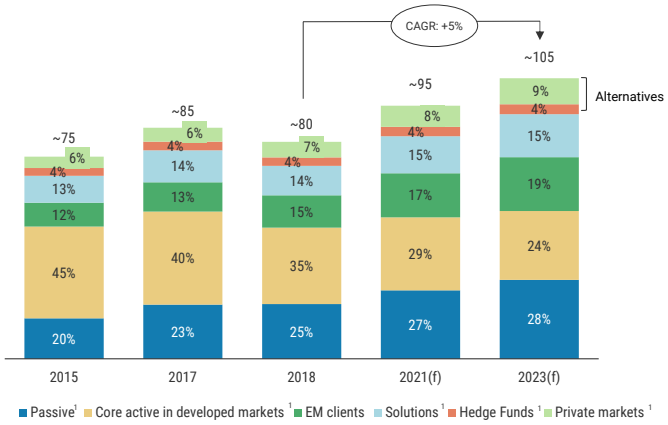
Exhibit 12:

Beneath modest industry revenue growth expectations, there will be dramatic shifts in the AUM and revenue pool composition mix

Base case global revenue composition, 2015 - 2023(f), USD BN



Base case year-end AUM composition, 2015 - 2023(f), USD TN



1. Does not include EM clients
Source: Oliver Wyman analysis

2. The growth zones

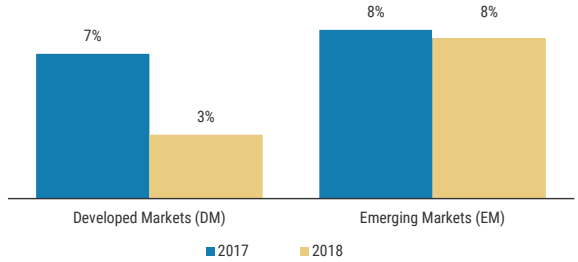
2.1. Growth zone 1: Emerging market clients

Currently, 85% of global AUM is from clients in developed markets; however, clients in emerging markets are now providing nearly 35% of new industry inflows, reflecting the shift of global wealth generation. Thanks to this, inflows from emerging markets clients have become more resilient of late than from developed markets.

Exhibit 13:

Asset managers face a race to capture resilient inflows from emerging markets

Net flows by region, 2017 and 2018 net flows, % of previous year YE AUM



	2018 DM	2018 EM
AUM	~USD 69TN	~USD 12TN
Inflows	~USD 2TN	~USD 1TN

Source: Oliver Wyman analysis, Morningstar

Over the coming 3-5 years, close to 70% of the growth in emerging markets client AUM will be from emerging Asia, with Chinese investors alone representing almost 50% of the growth.

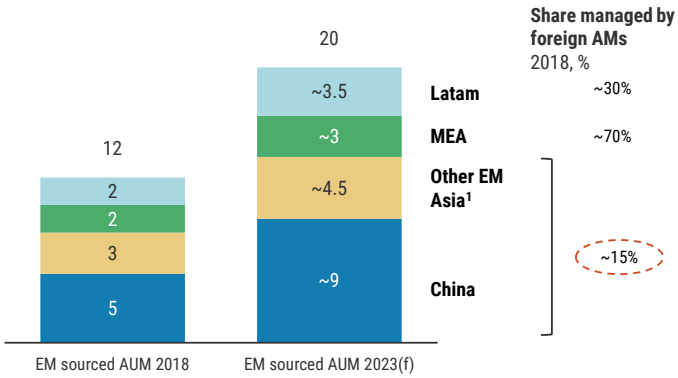
This presents a strategic challenge for global asset managers. Of the emerging markets regions, foreign asset managers have so far enjoyed the highest penetration in the Middle East, where the bulk of AUM is from large sovereign wealth funds with globally diverse portfolios. On the other hand, emerging Asia, and China in particular, has proven the hardest to penetrate, as reflected by foreign manager market shares.

Global asset managers that can successfully localize both their distribution and their product offering are placed to grow their market share. However, localization comes both at a sizable cost and impact on scale efficiency for many asset managers. As such, we expect the opportunity will only be accessible to a handful of foreign players, though the spoils for these could be meaningful.

Exhibit 14:

EM-sourced AUM is expected to grow at an 11% CAGR over the next 5 years, with half of this growth originating in China

Externally managed AUM sourced from EM clients by region, 2018 - 2023(f), USD TN



1. Excludes Japan and Australia, includes India, SEA, HK, Taiwan, Korea

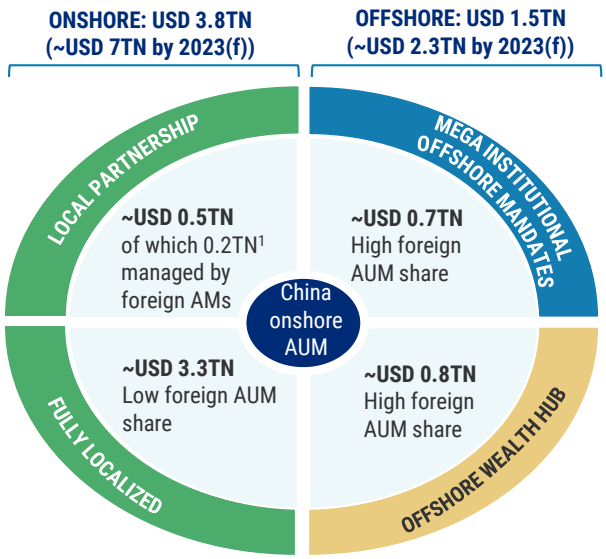
Source: Oliver Wyman analysis

China exemplifies this challenge well. The current China client-sourced AUM pool is $5.3tn, having grown at a 15-20% CAGR over the last 5 years. Today, one-third ($1.5tn) is managed offshore – e.g. international mandates from the largest public funds as well as high net worth individuals (HNWI) wealth booked offshore – and is highly accessible to global managers. The remaining two-thirds ($3.8tn) is managed onshore in a marketplace from which foreign asset managers have been previously largely excluded except through minority JVs and specific vehicles. As such, current foreign asset manager market share in this pool, including JV share, is still below 5% (~$0.2tn of ~$3.8tn onshore pool).

Exhibit 15:

Today, foreign asset managers play mostly in the offshore China market, having been largely excluded from the onshore market

Externally managed AUM sourced from Chinese investors accessible by business model, 2018, USD TN



1. Foreign AMs have on average ~35% of JVs

Source: Oliver Wyman analysis, Morgan Stanley Research

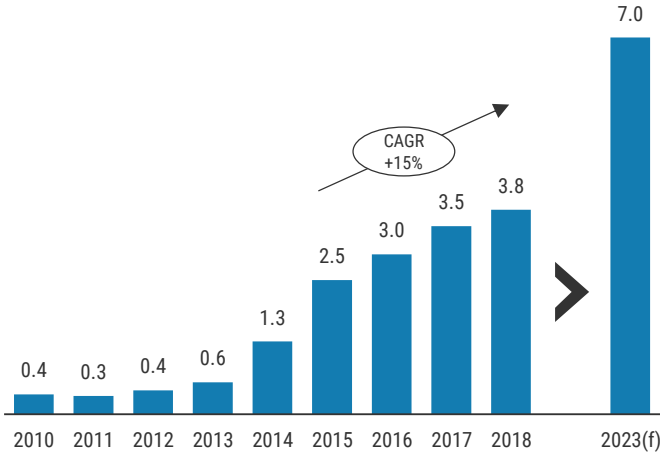
Over the next 5 years we project the China client-sourced AUM pool to grow significantly, driven by the onshore pool; we expect this pool to grow from $3.8tn to ~$7tn by 2023. There are four drivers that should help foreign asset managers increase their onshore market share :

1. Recent shifts in industry regulation, in particular the possibility for foreign asset managers to own a majority of a local fund management company and the loss of implicit guarantee for bank wealth management products;
2. Changing distribution landscape, e.g. growth in e-commerce and other new entrants in the fund distribution space with more open distribution models;
3. Potentially growing appetite for international diversification by Chinese investors, driven by regulatory simplification of how they can invest overseas, and growing interest by insurance clients in outsourcing parts of their portfolio; and
4. Foreign manager's "know-how" in equity and private markets, which are likely to see increased interest as the market continues to grow in sophistication and assets are re-allocated from fixed income into these other asset classes

Exhibit 16:

Onshore 3rd-party managed AUM in China has grown at a very fast pace over the past 10 years, and we expect this to continue over the next 5 years

Onshore 3rd-party managed AUM in China, 2010-2023(f), USD TN



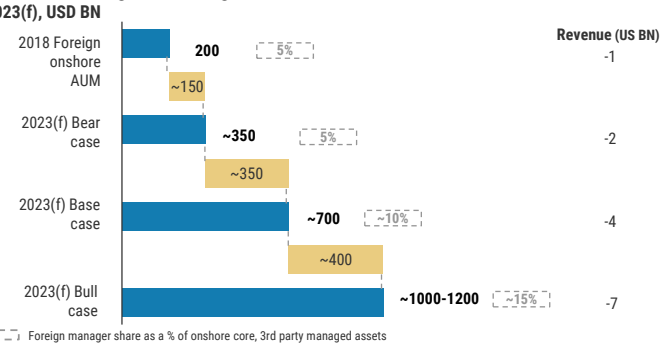
Source: Oliver Wyman analysis, Morgan Stanley Research

As a base case considering these drivers we forecast a ~10% market share for foreign asset managers by 2023, which would equate to ~$500bn of new AUM and revenues of $4bn versus $1bn today. We have defined a range of scenarios for this growth, noting that there is still considerable work to do by foreign asset managers in China, especially in getting access to distribution. A faster than expected opening up of retail distribution and strong appetite for equities and international diversification (potentially on the back of falling interest rates) would propel foreign managers towards the 15% market share in our bull case and up to $7bn in revenues.

Exhibit 17:

Changes to regulation and distribution landscape, together with a growing appetite from Chinese investors for diversification, present an opportunity for foreign asset managers to capture a higher share of China's growing onshore AUM pool

Scenarios for foreign asset manager share of onshore Chinese investor sourced AUM, 2018 v. 2023(f), USD BN



Source: Oliver Wyman analysis

Foreign asset managers are presented with a multitude of entry routes to access this growth. We lay out three of these routes. The first is to remain focused on the offshore pool, typically from a Hong Kong base. The other routes are a choice between joint venture partnering to get access to distribution (route 2) versus working towards majority ownership of a local fund management company (route 3). This process begins for most through a wholly foreign owned enterprise (WFOE) and private asset manager licence, with the intention of seeking regulatory approval to convert this to a full fund management company (FMC) licence , a process that takes at least 3 years. Another route, suitable for a few, is a joint venture partnership where the foreign asset manager buys out the local partner. So far, we see little interest from local banks in selling their stakes, but experience from more mature Asian markets shows this may change if distribution architecture becomes more open.

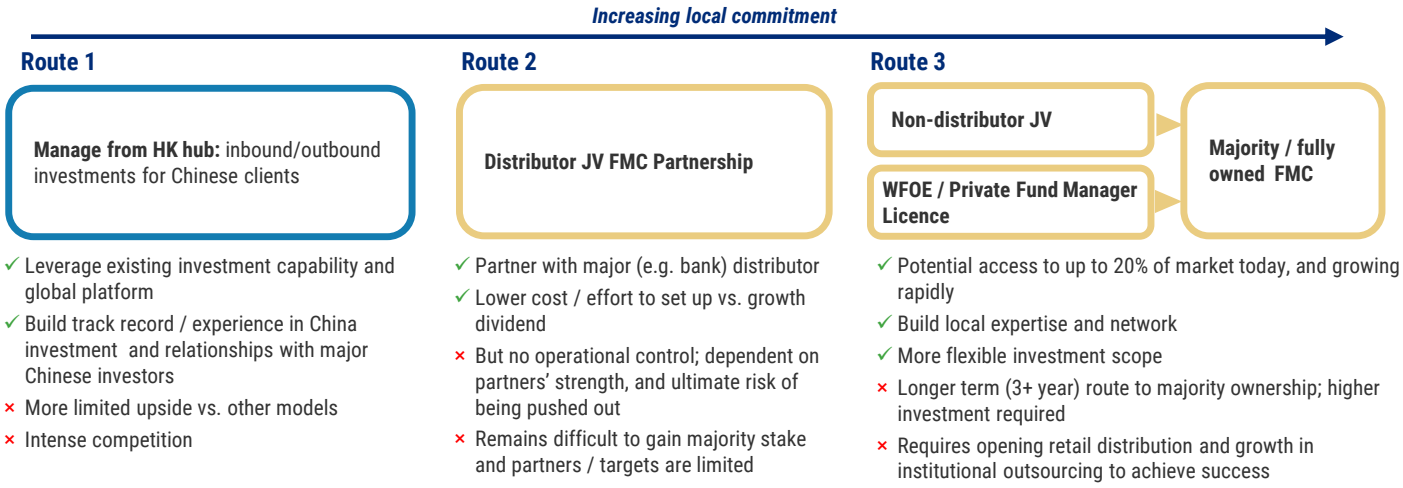
These routes are not mutually exclusive, with some foreign asset managers looking to pursue multiple routes to maintain optionality as the market evolves. A market where distribution remains dominated by retail banks but interest in overseas investment grows favors route 2, as we have observed in some neighboring Asian markets. On other hand, growth in the institutional and non-bank wholesale market (e.g. e-commerce platforms) is likely best captured through route 3, given the greater degree of freedom to operate.

In addition to the growth opportunity in onshore, the demonstration of commitment to local capital market development will be increasingly important in winning public fund mandates for offshore management especially as domestic asset managers seek to build out their own international capabilities.

Exhibit 18:

There are several potential routes for foreign asset managers to increase their share of Chinese client-sourced AUM

Comparison of different entry routes to Chinese investor AUM for foreign asset managers



AUM potentially accessible via each route by 2023(f), USD TN

~2	~7 across "localized" models

Source: Oliver Wyman analysis

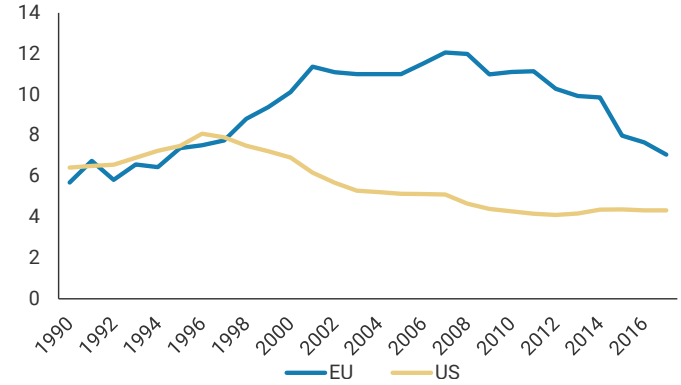
2.2. Growth zone 2: Growing access to private markets

Private markets are becoming an increasingly important part of the capital markets landscape. In developed markets, especially the US, the number of publicly listed companies has materially declined and private equity AUM (considering direct / co-investment and general partner (GP)-managed AUM) has outpaced growth in public market equity capitalization. High growth companies have the option of staying private for longer and taking advantage of increased secondary liquidity in private markets, which provides earlier stage investors with an alternative exit to the traditional IPO. Additionally, AUM in private debt and other real assets have risen rapidly too as investors have started to supplant bank lending, particularly in structured and sub-investment grade lending.

Exhibit 19:

As high-growth companies increasingly opt to remain private, the number of domestic publicly listed companies has dropped significantly in developed markets

Number of domestic companies listed on stock exchanges, 1990-2017, 000s



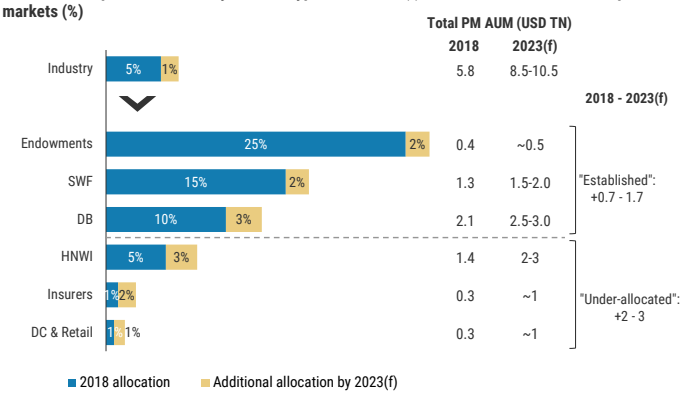
Source: World Bank

Up to now, much of the AUM growth has been driven by increasing allocation to private assets by established institutional segments (namely endowments, sovereign wealth funds and defined benefit (DB) pension plans). They have been attracted by access to growth, illiquidity premiums and the potentially lower mark-to-market volatility of private assets. However, over the next 3-5 years, we expect that a growing proportion of AUM inflow will come from segments that currently are under-allocated to private markets – namely HNWI, defined contribution (DC) pension plans and insurers. Currently, allocations from these segments are low due to 1) less familiarity with private markets; and, 2) structural constraints to investing in private markets such as limitations of retail / DC pension administration platforms to handle private assets, regulatory constraints and capital treatment considerations (for insurers). We note though that certain parts of private capital markets (e.g. leveraged buy-out private equity) currently have an ample supply of dry-powder capital waiting to be deployed and that any growth in supply will need to be matched by an increase in the demand for private capital.

Exhibit 20:

We expect currently "under-allocated" segments to increase their allocations to private markets and drive the majority of private market AUM growth

Allocations to private markets by investor type, 2018-2023(f), share of asset allocation to private markets (%)



Note: Direct real estate; indirect real estate funds or other forms of co- and direct investment are not included

Source: Morgan Stanley industry Research, Oliver Wyman analysis

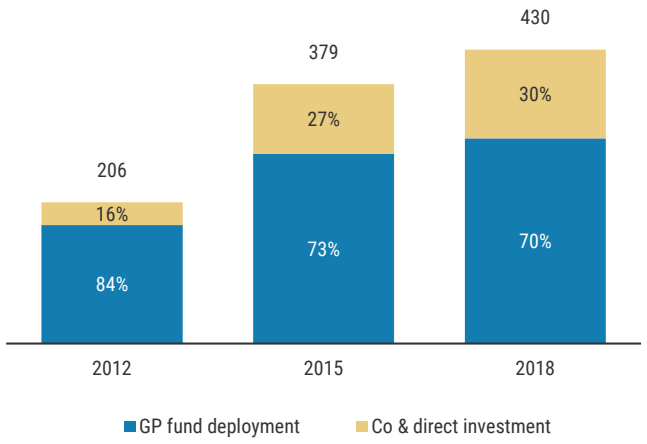
In parallel to this interest from under-allocated segments, we see a number of the largest established limited partners (LPs) continuing to build out their own direct/co-investment capabilities, typically to supplement investment through GPs. The relative importance of direct/co-investment capital versus GP fund deployment has grown materially over the last 6 years. While close relationships with these LPs remains critically important for GPs, a broadening of asset gathering from under-allocated segments will be a key growth opportunity for leading players.

Capturing this growth will require an evolution in distribution models, operating platform and product design. They will need to find alternatives to traditional LPs capital deployment arrangements and create product structures that work for HNWI and DC distributors.

Exhibit 21:

Major LPs are increasingly investing directly/co-investing into private assets to reduce total costs and gain control

Co-investment and direct investment as % of total PE capital deployed, 2012 - 2018, USD BN



Source: Morgan Stanley Research, Oliver Wyman analysis

If the potential in certain under-allocated segments can be unlocked, then the total revenue pool for private market asset management could match the pool for core active asset management in developed markets by 2023.

To date, public market asset managers have had mixed success expanding into private market asset management with private debt and real asset capabilities proving easier to integrate and drive synergies from than private equity, albeit at a lower scale for most. Growth in under-allocated segments coming into private markets may strengthen the case for asset managers to expand in the private market space, if they can sufficiently leverage existing client, distributor and regulator access.

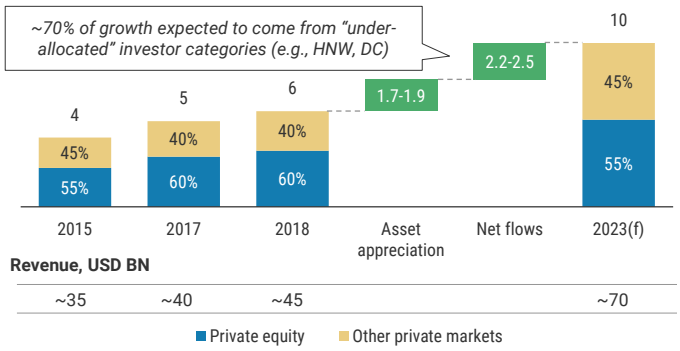
Acquisition activity in the private market and broader alternative space has picked up materially in the last few years, with deals in the space going from ~25% share of overall M&A activity in the sector in 2015 to >35% in 2018, and transaction count in the alternative space increasing 40% versus 2017. Traditional managers as well as managers with more narrow capabilities can look to complement their existing offering by acquiring more specialized players, thus gaining track record and resources in a very short period of time – and enabling them to move into adjacencies.

While overall asset manager valuation multiples are down, those in the private market space remain relatively high, making acquisition as a build route relatively more expensive. As an alternative to acquisition, asset managers should also carefully consider the product capabilities that they need in order to serve a broader segment base. For instance, funds that have long served "established" institutional LPs in private markets may not be used to working with the same portfolio risk controls or portfolio structuring capabilities that DC pension or insurance segment investors require or expect. In this case, an organic build-out leveraging existing capabilities may be a better option.

Exhibit 22:

Growth in other private market segments like real assets and private credit will outpace growth in private equity

Private markets AUM by segments, 2015- 2023(f), USD TN



Note: Other private markets include Real Estate, Natural Resources, Private Debt and Infrastructure

Source: Preqin, Oliver Wyman analysis

2.3. Growth zone 3: Solutions

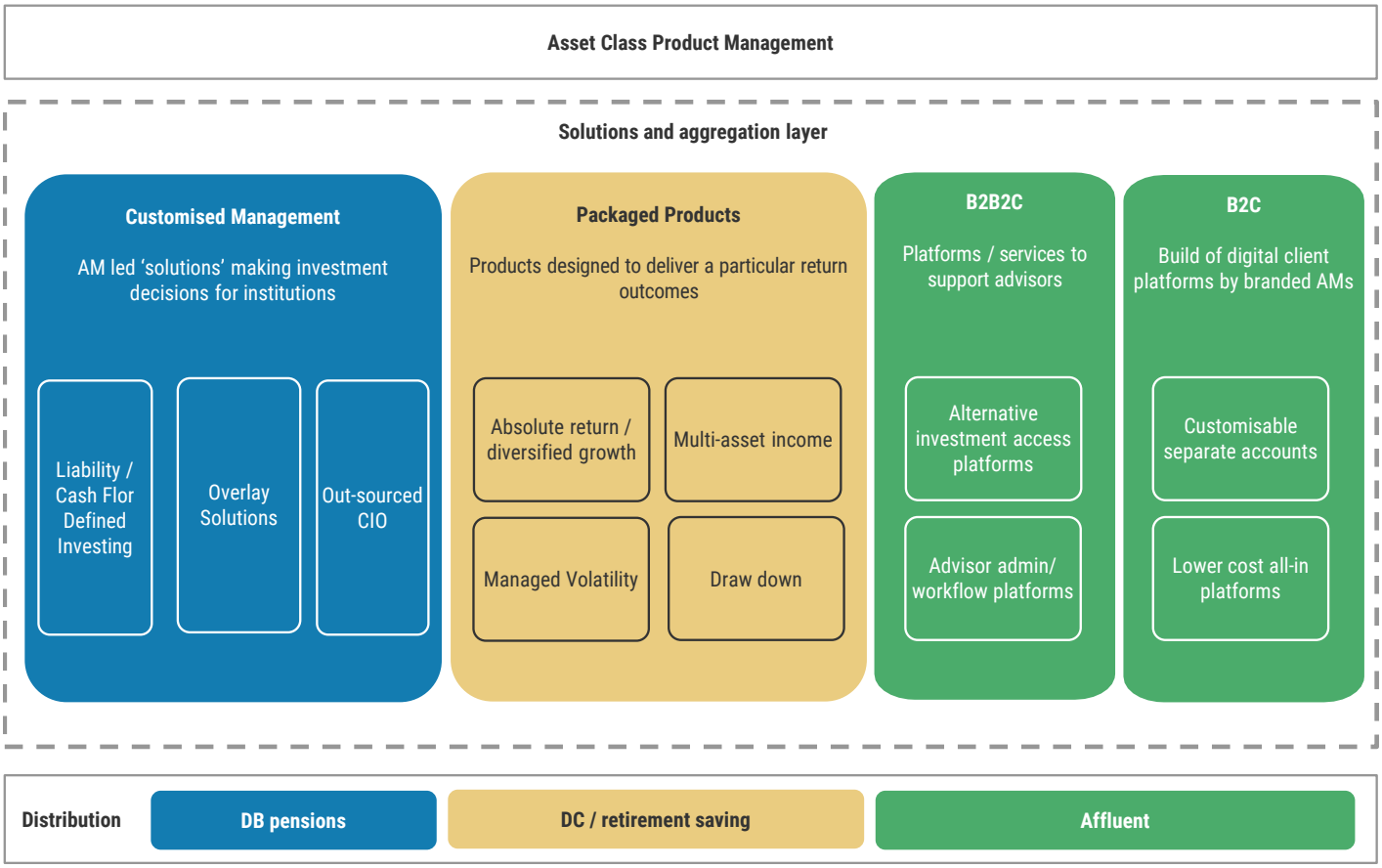
As asset managers have looked to redefine their value proposition, a fought-over "aggregation" or solutions layer has emerged in the asset management value chain between manufacturing and distribution. Asset managers are taking on activities that were previously performed by advisors or clients themselves at the distribution end of the value chain. Examples of this would be the growth in liability / cash flow defined investing (helping clients maximize risk and illiquidity premiums), outsourced CIO models (helping clients with portfolio allocation and structuring decisions) and outcome-oriented packaged products (designed to produce particular investment outcomes to match investor goals).

There are two main product sets in the solutions universe today: 1) lower-margin customized institutional management products, which account for ~70% of the $11tn AUM in solutions, and 2) higher-margin packaged products, which account for ~30% of AUM but ~70% of the solutions revenue pool. We expect continued steady growth from these product sets at 5% CAGR over the next 3-5 years. In particular, there are interesting opportunities to take solutions into new markets, for example developing target-date funds in China to support local pension reform.

Exhibit 23:

A fought-over "aggregation" layer has emerged, blurring the line between manufacturing and distribution, offering new areas for managers to compete

Example of services in the emerging solutions layer

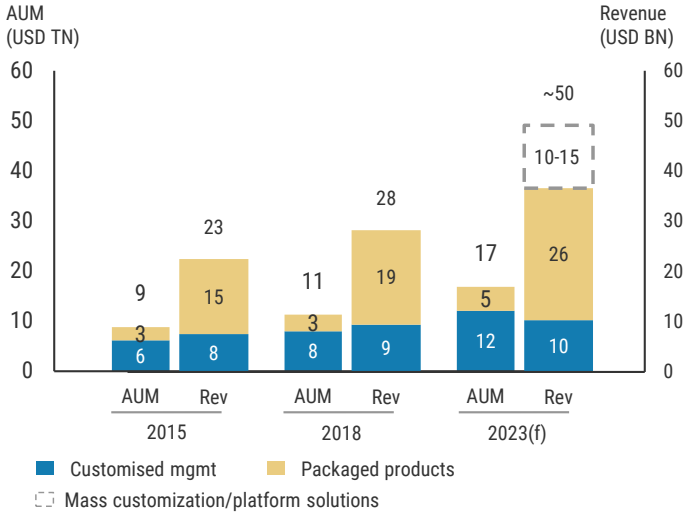


Source: Oliver Wyman analysis

Exhibit 24:

Packaged products are expected to drive revenue growth in solutions, with managers being able to charge higher fees for these products

Solutions AUM and revenue pools, 2015- 2023(f), USD TN (AUM) and USD BN (Revenue)



Source: Oliver Wyman analysis

Beyond this growth, the solutions concept will allow innovative asset managers to expand their value proposition. Rapid evolution in data management and digital automation is set to create new opportunities to bring customized investment management to retail retirement saving. The historical manufacturer-distributor divide is likely to blur as asset managers look to new forms of relationships with clients and their advisors, using sophisticated data techniques to better understand behaviors and preferences. A good example of this direction is the number of asset managers acquiring or building B2B2C platform technology. This is helping them build closer relationships with the retail advisor community by enabling advisors to better understand their clients and to improve their own value-add to those clients.

Such innovation offers access to new fee layers and revenue pools, potentially unlocking an additional $10-15bn revenue pool for asset managers by 2023 (additional to the aggregate $345bn asset management revenue pool in 2023). Innovation in this space allows for enhancements to the existing business – for example the use of better data to drive sales strategies or product design, or the build of API-based client interfaces that help automate portfolio maintenance activities and communication with clients.

However, the solutions space is increasingly scale driven, and not all asset managers will be able to compete, given the required range of investment capabilities as well as the required technology budget. Asset managers will increasingly find themselves up against technology players in the solutions space. While this creates a wide range of interesting partnership opportunities, it also adds an onus on solutions asset managers to learn from and adopt the innovation culture of the most successful technology firms – a transition that many are grappling with today. The unexpected rise in ETFs highlights the need to marry both cultures and ensure that innovation spend is truly transformative.

3. Defend or attack?

Given the revenue growth outlook laid out in this report, asset managers are faced with critical decisions about both where to defend and where to attack.

The first question is where and how to defend the existing active business. There are several steps active asset managers could take, including:

- Focusing on shareholder stewardship to both improve returns and respond to increasing investor expectations in this area. Stewardship is, however, not unique to active asset management, and the rise of ESG-focused passive strategies indicates that this is likely to be a competed ground. Active managers will need to go further by demonstrating the case for active ownership.
- Using data and analytics to help investors understand the value and role of active risk in their portfolio, to find the most effective ways to gain exposure to these risks and offer these strategies at lower fees.
- Delivering active management at a materially lower price point by re-engineering the end-to-end fund operating and distribution model – noting that for many retail investors management fees are only one component of their total fund costs. Innovative pricing will also play its part, such as investor-aligned performance fees combined with a lower base fee.

There is a real risk in not acting, and instead being forced into a more reactionary response down the road. Many asset managers will lack the scale and know-how to aggressively attack in the three growth zones described previously, and will therefore need to defend the active core to ensure survival.

The second question will be around defining the level of investment and participation models to develop in the target growth zones. For each zone there are different build, partner and acquisition options around distribution access, investment capability sourcing and gaining technological / data management expertise. Making room for

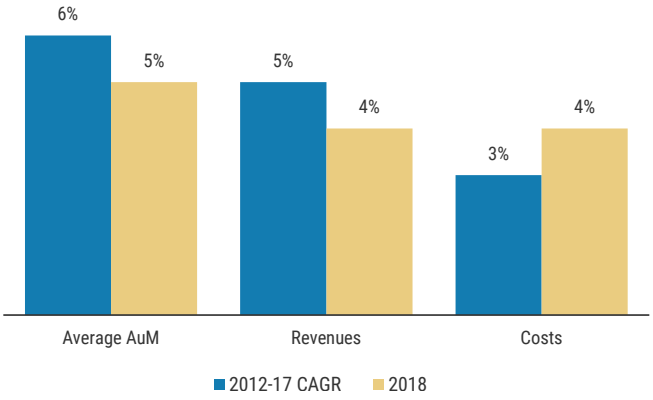
investment capacity will be important, including redeploying capacity from declining business areas, with the most aggressive asset managers likely investing up to 5-10% of existing revenue on the growth zones.

The asset management industry has the potential to cut up to 30% of its current cost base through a combination of improved automation, outsourcing and rationalization. The industry currently outsources less than 25% of its cost base but could increase this to as much as 50%. In fact, the industry still has a long way to go with costs still rising by 4% in 2018. This highlights the fact that, while many institutions are trying tactical steps to reduce costs, these are only marginal compared to what is required.

Exhibit 25:

The industry continues to struggle to find cost efficiency savings to counterbalance margin compression and invest for growth

Evolutions of industry economics, 2012 - 2018, % change



Source: Oliver Wyman analysis

Merger consolidation and full IT replacement are two well tried approaches to reduce asset management costs, both with mixed track records of success. The experience from retail banking, where we have seen an increasing number of successes of building businesses from a completely blank canvas, has been that a greenfield approach can provide an alternative route. Starting from the ground up allows for a build that is agnostic to legacy technology design, leading to more room for innovation and greater focus on customer-centricity and technology.

One of the key objectives of a greenfield build is to create a clean and modular technology architecture, with a data integration and application orchestration layer. The application orchestration layer gives institutions the flexibility to "plug in" and experiment with service providers, drive process automation through use of third-parties, support new operating standards, and build new levels of customer understanding. The data integration layer can enable asset managers to adopt a more customer-centric data model designed to generate customer insight and increase process automation. Further, it can give players of sufficient size the ability to move from being passive "takers" of data from third parties, which often requires timely data processing and transformation, to being able to dictate the form in which they would like to receive the data. Modular architecture and platform-based outsourcing can help overcome existing concerns around dependence on one specific partner.

The time-to-market and cost of building a technology platform from scratch has decreased dramatically thanks to advances in cloud-based services and technology. By starting with a blank slate, it is possible to create operating models that are digital by design and have up to 70% lower operating costs and avoid any disruption to existing business, clients and reputation. We believe this model offers an exciting experimentation opportunity for asset managers both in helping defend the core active business and in attacking the growth zones.

In closing, the asset management industry does not have time on its side. Tweaking existing operating models will not be enough to either respond to aggressive pricing challenges or free up investment capacity for growth. Transformative action is required.

Wholesale Banks: Tailwinds Faltering, The CEO's Challenge

1. The growth challenge

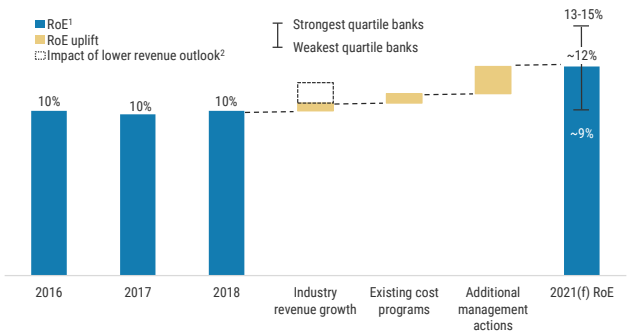
In an environment of low growth and disruption, management teams need to act boldly to drive up returns. Industry-wide fee pools look set to continue a path of modest growth of ~1% CAGR, but with pockets of the business showing significant upside around this. At the same time there are opportunities for radical re-invention of the business model that will drive faster growth and strip out costs through broad-based restructuring. The winners will be those with the investment budgets and decisive leadership to attack both break-out growth initiatives and efficiency opportunities.

The most at-risk banks will have to cut deeply to free up the investment needed to defend their core franchises. That may mean further business exits and more aggressive shifting of resources away from low growth and low profitability areas. Our estimates suggest that the industry RoE can climb to ~12% on average by 2021, based on a combination of market growth and accelerated management action. Winners will deliver 13-15%, while the bottom quartile will struggle to hit 10%.

Exhibit 26:

We estimate that industry RoE will only reach 12% in 2021 more radical action is taken

CIB industry RoE, 2016-2021(f), %, including management actions



1. RoE based on standardized 30% tax rate and 12% cost of capital

2. RoE impact of lower revenue outlook, compared to industry expectations this time last year

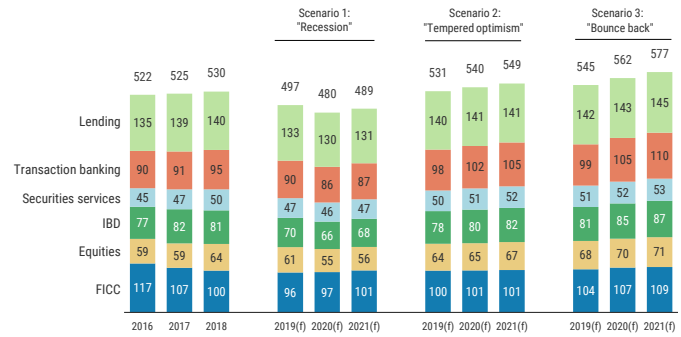
Source: Oliver Wyman analysis

The urgency to act has increased as the revenue outlook has deteriorated off the back of a weaker economic climate, lower interest rate expectations and lack of resolution around Brexit and US-China trade tensions. Structural headwinds remain driven by pressure on the institutional client base and over-capacity. Together these factors lead us to expect revenues to grow at ~1% CAGR in our central scenario, down from the 3% CAGR expected across the industry through most of 2018. We have sketched out two alternative scenarios, a mild recession and a modest bounce back (see side bar at the end of this section).

Exhibit 27:

We estimate that revenues will grow at a compound annual growth rate of ~1% in our central revenue scenario of "Tempered optimism"

Wholesale Banking industry revenue forecasts, 2016-2021(f), USD BN



Note: Only includes revenues from corporate clients with an annual turnover of over USD 1.5BN. FICC includes G10 Rates, G10 FX, Emerging markets, Commodities, Credit and Securitization. Equities includes Cash, Equity derivatives and Prime services. IBD includes DCM, ECM and M&A. Transaction banking includes Trade finance and Cash management

Source: Oliver Wyman analysis, Coalition proprietary data

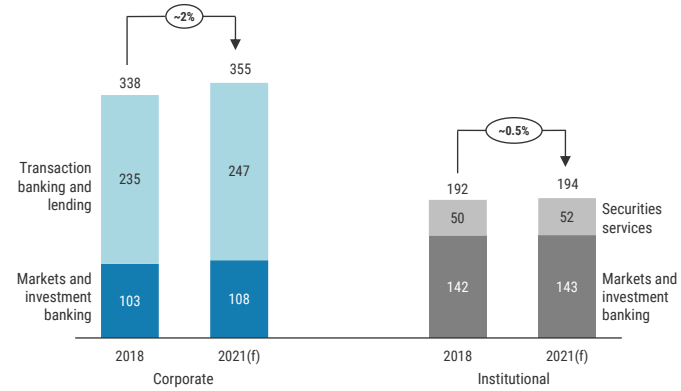
Sales & Trading businesses look set to remain stagnant, some players will need to explore creative ways to capitulate. The weak growth outlook reflects trailing impacts from MiFID II in Europe, structural pressures on the asset management industry, such as the shift to passive investing, and margin pressure brought on by the rise of non-bank liquidity providers. Revenues have fallen 15%, or 3% CAGR, over the last 5 years, with Fixed Income most impacted. Banks that are suffering the most intense revenue contraction will be pressured to explore ways to change their business models, including through partnership models and strategies of creative capitulation that outsource front office activities (for instance pricing and liquidity provision) to third parties, to improve customer propositions and boost profitability.

Corporate clients are a key growth area, but the businesses serving these clients are in need of transformation. Transaction banking revenues grew strongly in the USD-denominated regions in 2018, and we see further room for growth of 4% CAGR linked to underlying corporate activity. However, other areas of the corporate franchise look set to grow at a slower pace in the current environment. Furthermore, the aggregate economics of this business may be less attractive if weighed down by capital-intensive, low-margin lending books, legacy infrastructure and expensive client coverage models. The danger for incumbents is that quick moving competitors and new entrants disrupt the market and attack the profitable and faster growing business lines of transaction banking, changing the cost structure and leaving incumbents to compete in less economically attractive and slower growing elements of the business.

Exhibit 28:

Corporate wallets continue to be attractive as we forecast 2% CAGR over the coming three years

2018-2021(f)[1], USD BN and % CAGR



1. Revenue forecasts based on "Tempered optimism" scenario

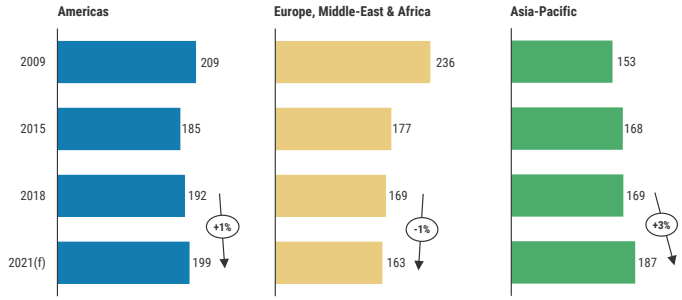
Source: Oliver Wyman analysis, Coalition proprietary data

Asia-Pacific is now as large a market by revenues as EMEA, and Asian banks are emerging as advantaged competitors. We forecast the EMEA CIB revenue pool will shrink by ~1% CAGR over 2018-21, adding to the 28% decline the region has experienced over the last decade. This implies that there will be over $50bn in excess capital allocated to the region by CIBs relative to the capital that can be supported by the revenue base. EMEA CIB capacity will have to come out. In contrast, we expect growth in APAC of ~3% CAGR. Growth will benefit local banks in Asian emerging markets as well as the group of international banks that also have strong and profitable corporate franchises. Local banks will continue to play to their strengths while also investing to narrow the capability gap between their CIB products and those of the international banks.

Exhibit 29:

Asia is now a larger market than Europe, and we expect differentiation in regional growth rates to reinforce this trend

CIB revenues by region, 2009-2021(f)[1], USD BN and % CAGR



1. Revenue forecasts based on "Tempered optimism" scenario

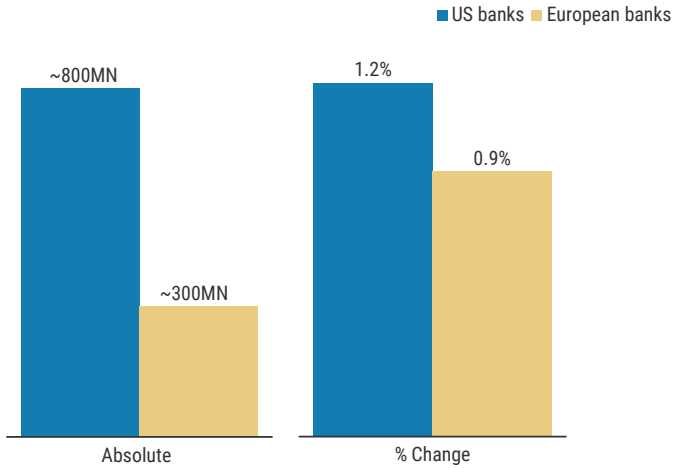
Source: Oliver Wyman analysis, Coalition proprietary data

US Banks will want to pivot to new areas to drive revenue growth in excess of the market. Their scale is their ally, a critical advantage to fund investments and change-the-bank initiatives. Given their skew to slower growing institutional clients, US banks will need to direct investment dollars towards new markets, or faster growing client segments e.g. the CFO-down product suite activities. With their home market in the world's reserve currency, they have a leg up on extending their reach or increasing competitiveness. But even if US banks simply hold share around their existing footprint, meeting current targets will be challenging, although they will still grow at a faster rate than their largest European rivals.

Exhibit 30:

The revenue outlook favors US banks over Europeans as a group, before the impact of incremental management action or market share gain is felt

US vs European banks forecasted revenue change[1], 2018-2021(f), USD MN and % CAGR



1. Average change for leading US and European banks for inscope products

Note: Excludes impact of any potential market share transfers

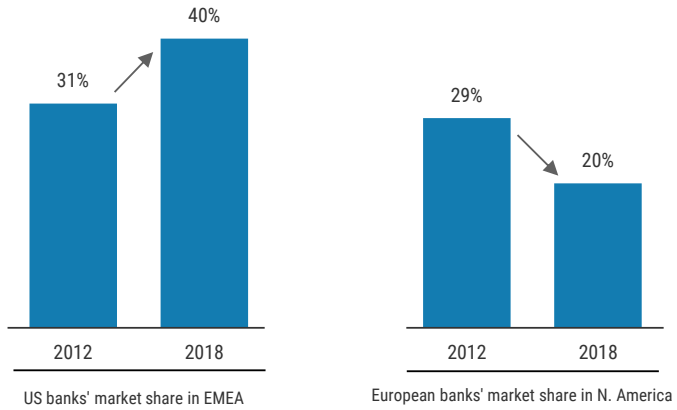
Source: Oliver Wyman estimates and analysis, Coalition proprietary data

Source: Oliver Wyman estimates and analysis

Exhibit 31:

European banks have been losing market share in North America while US banks have gained share in EMEA

US and European banks' market share[1] evolution, 2012-2018, %

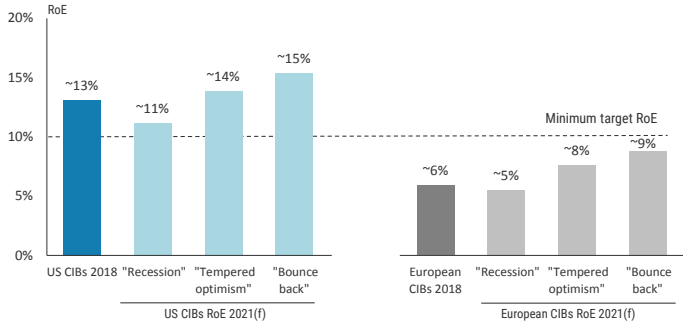


1. Sales & Trading and IBD

Exhibit 32:

US banks will consolidate their leadership positions, prior to any management action

RoE for US and European banks, CIB divisions only, forecasts based on market growth for our three revenue outlook scenarios, and already announced cost savings programs (%) 2018-2021(f)



Note: Excludes the impact of any additional management action beyond what is already in flight
Source: Oliver Wyman analysis

European banks may have to cut harder and make tougher choices to drive returns up. Ten years after the crisis, European investment banks as a group continue to struggle to generate returns above their cost of equity. Their skew towards shrinking European markets and challenges faced in flow businesses (that require scale to be profitable) are likely to widen the gap to US rivals. We estimate that by simply growing with the market the largest European banks will see the absolute revenue gap to US leaders widen by $500mn on average. Combined with their existing profitability advantages, US banks will have a substantial buffer relative to Europeans to protect strategic investments in a downturn, further increasing the disparity.

Over the last decade European banks have lost almost 10 points of market share to US banks in both home and US markets. As hopes for a revenue uplift driven by improving economic conditions have fallen away and strategies to recapture market share have largely failed, questions are being asked about the sustainability of European CIB business models. Restructuring efforts will need to be intensified to boost returns and increase confidence. Chronically unprofitable institutional businesses – such as flow trading – are understandably in focus. Restructuring or capitulation in areas of these businesses may be necessary to free up the vital investment funds and management bandwidth required to win in attractive areas such as corporates and wealth management.

What could the revenue landscape look like?

Our revenue forecasts over the next three years are based on regression analysis across a proprietary database, covering 24 years of revenue data at both a granular product and regional level. We looked at 25 macro-economic variables, and those with the most robust and intuitive correlations to past performance were selected to inform forward-looking predictions.

We modelled the expected evolution of these variables across three plausible macro-economic scenarios, covering a recession, a central scenario of tempered optimism, and a more optimistic bounce back scenario, over a three-year period from 2019 to 2021.

Exhibit 33:

Macro-economic variables with the most robust correlations have been used

Macro-economic variable strength of correlation to product revenues

Strength of correlation to revenues

Strongly positive | Positive | Negative | Strongly negative

Product	Macro-variable 1	Macro-variable 2	Macro-variable 3
G10 Rates	10y – 3m spread	BBB spread to 10y T	UST 3m yield
G10 FX	Global GDP index	VIX	TED spread
Emerging markets	EM Volatility	S&P GSCI	MSCI world
Credit flow	Global GDP index	BBB spread to 10y T	US BBB Corporates
Credit structured	BBB spread to 10y T	TED spread	
Securitised products	MBS outstanding	TED spread	UST 3m yield
Commodities	Global GDP % YoY	S&P GSCI	
Cash equities	MSCI world	VIX	
Equity derivatives	MSCI world	VIX	
Prime brokerage	MSCI world	UST 3m yield	
Debt capital markets	UST 10y yield	VIX	
Leveraged finance	MSCI world	UST 10y yield	
Equity capital markets	MSCI world	VIX	
Mergers & acquisitions	MSCI world	UST 10y yield	
Trade finance	Global GDP % YoY	TED spread	UST 3m yield
Cash management	Global GDP % YoY	TED spread	UST 3m yield
Lending	Global GDP index	UST 10y yield	US BBB Corporates
Securities services	Global GDP % YoY	UST 10y yield	US BBB Corporates

Source: Oliver Wyman analysis, Morgan Stanley analysis

Exhibit 34:

We have modeled three plausible scenarios for industry revenues

Alternative revenue scenarios and expected impact by region and client type

Scenario descriptions

Scenario 1: "Recession"	Scenario 2: "Tempered optimism"	Scenario 3: "Bounce back"
• Geopolitical and trade tensions escalate as well as debt problems, leading to a weaker recovery in global growth • Interest rates fall across the US and Europe, but do not spur economies • Rising corporate defaults in US, Europe and China, alongside falling global trade	• Geopolitical tensions persist, but do not escalate. Growth remains weak but positive • Asset prices stabilize and interest rates remain flat or fall modestly • Corporate defaults increase modestly in both Europe and the US	• Improving macroeconomics combined with de-escalating geopolitical tensions, leading to stronger growth • Lending increases and interest rate rises increase profitability for banks • No significant increase in inflation or corporate default rates, but modest uptick in volatility provides trading opportunities

Wholesale Banking industry revenues, 2021(f) (18-21% CAGR)	USD 489BN (-3%)	USD 549BN (+1%)	USD 577BN (+3%)
Region			
Americas	↓	↗	↑
EMEA	↓	→	↗
APAC	→	↑	↑
Client type			
Institutional	→	↗	↑
Corporate	→	↑	↑↑

Source: Oliver Wyman analysis, Coalition proprietary data

In our central scenario, growth sits at just ~1% CAGR to 2021. FICC and Lending suffer most from the challenged economic outlook, and the skew of revenues towards the slower growing European market. Added to this, we see structural headwinds to revenue pools driven by a combination of bank capacity withdrawal and trailing effects of MiFID II, which has put pressure on flow trading businesses and has eroded 20-30% of revenues from Cash equities businesses in Europe.

Regulation and shifts in market structure, notably the increasing role of non-banks and the shift to electronic trading, have a profound impact on flow trading businesses in all scenarios. This dampens the positive impact of volatility, which historically has been a central driver of rising revenues.

We expect Equities to perform better at ~2% CAGR, although 2019 could be more challenging given the tough 2018 comparison. The sensitivity to sustained equity indices and volatility levels is significant, and we have factored in a much larger negative impact in our recession than upside in our bounce back scenario. This reflects the fact that banks have not seen as much revenue growth as Equity markets have appreciated over recent years.

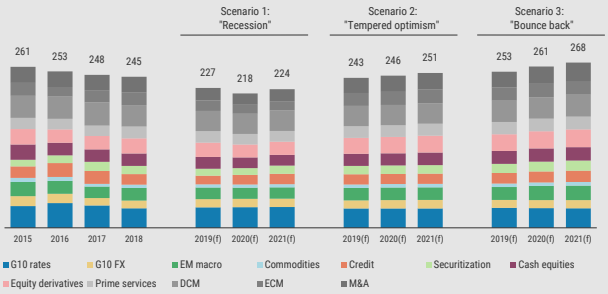
Outside of Sales & Trading, we forecast cyclical normalization of DCM and M&A for 2019 driven by a concern over macro-economic conditions and a reduction in tailwinds from tax reform in the US. But we would expect growth to return under stable macro-economic conditions. Similarly, Securities services and Corporate lending are likely to suffer from slower growth in 2019 due to a moderation in interest rates. These are set to show strong growth if the economic outlook remains positive, particularly in the US and Asia.

In a recession, trade tensions, low growth and falling interest rates would have a profound impact on revenues. Macro businesses could see a modest boost as volatility rises and there is a flight to safety among investors. However, as outlined above, macro businesses are now less able to capture the full benefit of volatility than in the past. Economic growth-driven businesses and corporate franchises would suffer from weaker GDP and falling interest rates. The big uncertainty is how steep declines could be in credit markets. We have modelled declines of ~20% of revenues, which is in line with previous dips, although clearly there is scope for much more substantial losses driven by write-downs. Putting this together could leave revenues down by over $40bn by 2021 from 2018, with the steepest declines in 2019.

Exhibit 35:

Revenues for Sales & Trading and IBD divisions look unlikely to recover

Sales & Trading and IBD industry revenue forecasts, 2015-2021(f), USD BN



Note: Only includes revenues from corporate clients with an annual turnover of over USD 1.5BN

Source: Oliver Wyman analysis, Coalition proprietary data

2. Restructuring agenda: Target legacy to get efficient, leverage tech and data

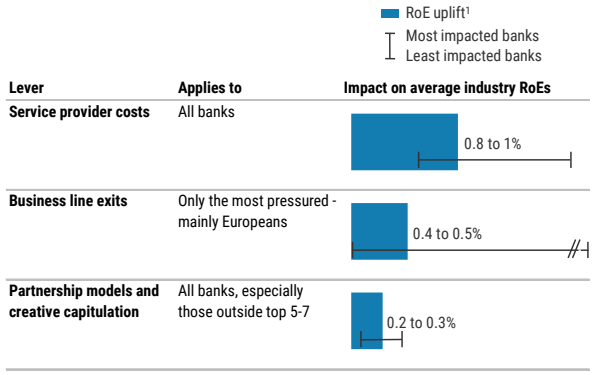
To drive up profitability and fund the investment needed to drive growth, we see a need for significant restructuring and cost release from the core business. We see three broad levers that different banks will need to pull to a lesser or greater degree:

- Service provider costs
- Business line exits
- Partnership models and creative capitulation

Exhibit 36:

RoE impact of delivering on the restructuring agenda

CIB-wide RoE uplift from range of management levers, 3 year time horizon



1. Average impact calculated on overall industry RoE, with range reflecting the spread around this for individual banks
Source: Oliver Wyman analysis

All banks will need to tackle service provider costs

Front office cost measures alone will not suffice. The industry has proven adept at squeezing 5-10% from front office costs in response to weak revenues. But this will not be enough to achieve return targets. Banks need to bring a wider portion of the cost base into scope for more radical exercises than they have done in the past. In our experience, expanding the cost cutting efforts to include allocated costs and support functions can more than double achievable savings compared with incremental squeezing and efforts that are centered on the front office alone.

Industry-wide, we estimate 12% of costs could be taken out through comprehensive action across both front office and support functions. This would rise to 20% at the most inefficient banks, if taken alongside more radical restructuring actions.

Three sets of support function focused initiatives stand out as a high priority:

- **Streamline support function management:** Banks need to simplify management structures across support functions, for instance by globalizing activities, processes, systems and teams, and reviewing legal entity operating models. At some institutions this could even extend to structural organization redesign, such as by re-aligning activities across functions, or even consolidating functions with significant overlaps.

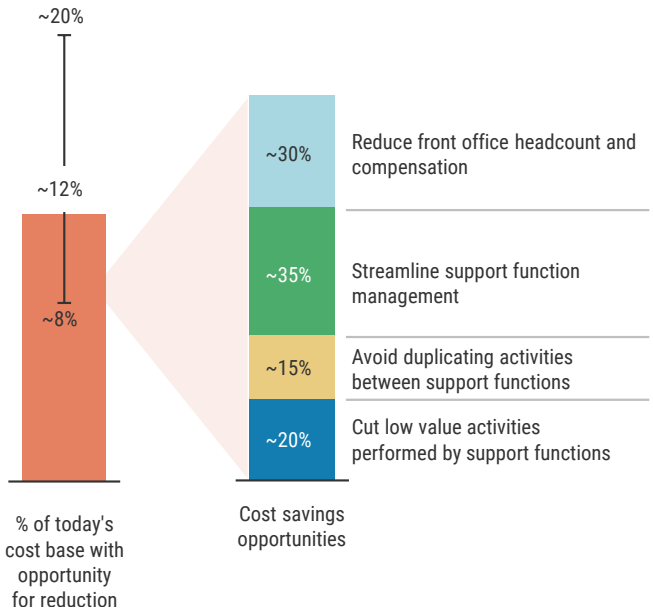
- **Avoid duplicating activities between support functions:** A growing number of activities are duplicated in different parts of the organization. For example, conducting separate stress testing exercises both at a Group- and legal entity- level, with limited integration and few links to business strategic planning exercises. Establishing single points of ownership can remove some of this duplication and can reduce third party spend by consolidating buying points for similar services, such as data provision.

- **Cut and automate activities performed by support functions:** Banks need to spend less time doing manual processes where the value or delivery model has not been challenged or compared to alternative automated solutions (e.g. production of management reports). Identifying these should be an ongoing process, but this has received insufficient attention in recent years.

Exhibit 37:

Focusing on potential savings in support functions can more than double achievable savings compared with efforts centred on the front office

CIB wide, 3 year time horizon, %



Source: Oliver Wyman analysis

These efforts should go side-by-side with a wider set of digital transformation initiatives (e.g. onboarding and reconciliations) aimed at generating efficiency savings while reducing the number of points of friction experienced by customers or other external stakeholders, such as regulators. These are typically focused on processes that cut across organizational silos, creating considerable inefficiencies across teams who use different tools and protocols. Client facing processes, such as onboarding and lending approval, are obvious examples in the corporate banking space where efficiency gains of >40% have been demonstrated in individual areas. Risk and control functions, and the processes that surround them, are also being looked at hard for potential improvements.

Reform in risk and control functions

Second line functions have had to tackle a wave of new regulatory requirements that have demanded they aggressively build up teams with overlapping capabilities and responsibilities across teams, legal entities, etc. The resultant operating models are not what someone would have designed if they had started with a blank piece of paper.

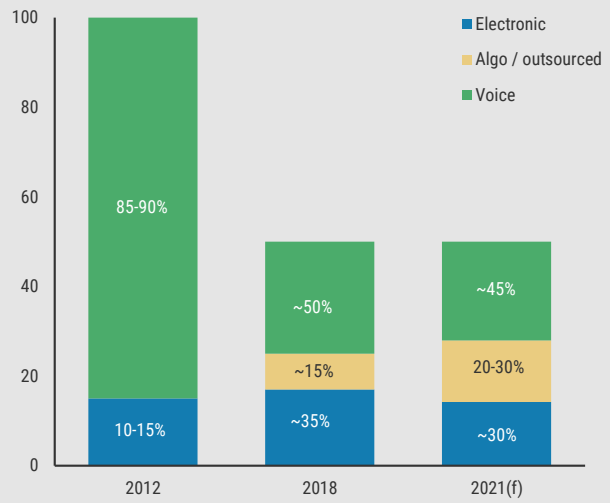
After a decade of focusing on regulatory demands, organizations are struggling to adapt to new business needs and roll out more efficient technology solutions in place of manual processes. Banks need to be surgically precise about how they take out costs as they cannot risk affecting quality or effectiveness of control/risk management. But there are savings to be made, for instance by automating processes and using technology to perform initial screenings, thus focusing human intervention.

As they launch reform programs, banks need to better match capabilities to the risks of new and future business models and establish best practices around these. The ongoing shift towards algo trading and straight-through-processing of trades reduces traditional risks as they increase balance sheet velocity, allow for more comprehensive hedging, and remove some risks created by human errors. But in their place come new concerns such as operational resilience, risks of losing money in flash crashes, and conduct risks arising from automation.

Exhibit 38:

Risk functions should match their capabilities to shifting business models

Balance sheet generated in Fixed income Sales & Trading, by execution channel, 2012-21(f), 2012=100



Source: Oliver Wyman analysis

This will require closer collaboration between first and second line functions, facilitating better cross-functional understanding of the challenges faced by business divisions – ultimately improving the agility of the organization. This should improve effective risk management and allow for costs to be extracted from the legacy organization. To unlock this, banks will need to proactively engage with regulators to test and explore options.

Some banks may need to exit chronically unprofitable businesses

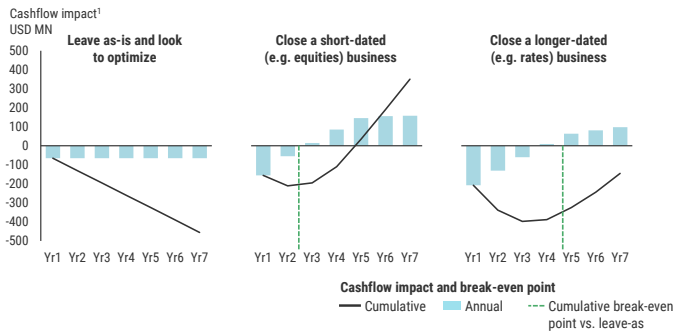
Further business line exits may be needed for the most pressured players. In pursuit of optionality, banks have maintained too many uneconomic businesses – both at an asset class and regional level – that have little prospect of returning to profitability. This has partly been driven by legitimate uncertainty around the outlook and short-term challenges associated with allocated costs. As economic realities have hardened, the greatest impediments to action are the costs associated with closing businesses and the fear that exiting products negatively impacts the rest of the franchise. Rates, Credit and Equities businesses offer the most attractive opportunities for wide scale exits, particularly outside of home regions.

Stubborn service provider costs limit strategic action. Service provider costs have acted as an anchor on current performance and, perhaps more importantly, have limited strategic options. Revenues quickly fall away, whereas costs and balance sheets move more slowly – leaving a heavy deficit for banks to fund. Our experience shows that just ~30% of costs allocated to businesses are flexible enough to move in line with revenue reductions. A further 40-50% of functional costs can be removed, but there is always a significant time lag as systems are wound down and contracts expire. This leaves a final 20-30% of the cost base in central functions that bears almost no correlation to the size or scale of the business. As businesses are closed, these costs must be allocated to other parts of the bank.

Exhibit 39:

Exiting uneconomic businesses requires banks to get costs out faster

J-curve impacts of closing whole business line, based on a business generating USD 500MN of revenues at 95% CIR



1. Cashflow impact based on revenue minus costs minus the cost of funding the balance sheet and other financial resources

Note: Assumes average cost of funding. Higher funding costs would bring forward the "break-even" point as releasing balance sheet would be more impactful. Cost modelled with an industry-average split between variable front office, aligned support function, and fixed Group costs. Tax impacts not included

Source: Oliver Wyman analysis

Economic benefits can accrue – but slowly. Set against the costs of business exits are the benefits of capital release and lower funding costs, due to a smaller balance sheet. The net result is that banks rack up steep losses in the period immediately after exiting a business; it is only much later that the economic advantages outweigh the initial cost of closure.

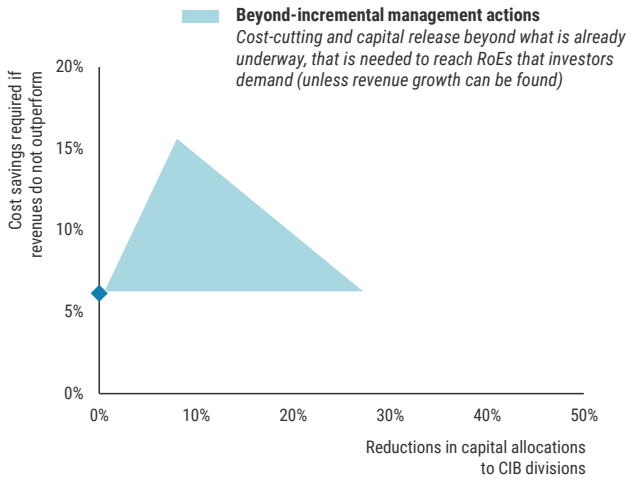
We estimate that closing a business that generates $500mn of revenues at 95% cost-income will incur cumulative costs of between $200mn and $400mn, with cash flow breaking even relative to inaction within 2 years. This break-even point moves out considerably for businesses with longer-dated assets. The key sensitivities are the maturity and market value of the assets, the cost of funding the balance sheet, and the ability to strip out support function costs. Banks that are able to shift the calculation across one or more of these dimensions will boost the economic case for action.

Banks with an outsized exposure to Europe will have to go further in cost cutting than they are planning. We estimate that cost programs already launched by this group will deliver cost savings of 6-8% relative to 2018 levels. But this leaves the group with an average RoE of 8% by 2021, assuming they grow in line with the market. This is lower than the minimum acceptable target of 10%, and we calculate even top performing banks in this cohort will be below the 12% that has historically been the industry target. Steeper cost and capital reductions will be needed to close this gap.

Exhibit 40:

Banks with the biggest exposure to Europe will need to cut resources most heavily

Incremental cost and capital savings required to deliver +10% RoE for European-centric CIB divisions, 2018-2021(f), %



Source: Oliver Wyman analysis

Partnership models and creative capitulation could be an attractive alternative in flow businesses. A combination of macro-economic conditions and sectoral trends – notably regulation and the rise of non-bank liquidity providers, has ground down the revenues and profitability of traditional flow trading. We estimate that over the last 3 years falling margins and rising capital commitments have cut 15% from S&T revenues, and profits have been cut further by the costs of regulation and required platform investments. Investors have responded to this and we estimate that the implied market value of the global S&T industry has fallen by 25-35% since 2015. Industry level RoEs for these businesses are below the cost of equity – although skews are significant. The largest players enjoy significant scale benefits – the network benefits of large client franchises and internal liquidity pools, and the deep pockets to fund continuous technology investment. Some smaller players are struggling to cover costs, let alone deliver a return on capital in these markets.

Further automation of the flow business offers potential to improve returns but requires significant investment and time. The trading model of the future will be underpinned by a greater source of real-time analytics, producing automated prices that are distributed to clients using APIs. Tailored trade ideas will be generated by vast internal and external sources of information about clients, and prices will be generated by machines assessing the impact a trade will have on the market and the expected profitability and risk. This will allow for real-time pricing, risk management and resource allocation decisions. The automated set-up will allow trades to be auto-affirmed and processed front-to-back, without the need for operations staff to manipulate trades manually through the lifecycle – improving efficiencies across support functions.

Leading banks are already deploying AI for price construction, from building central risk books, to moving towards a modular technical architecture, as well as aligning data libraries and models across first and second line functions. But there is more change still to come, and all banks will need to roll out their own solutions and initiatives to keep pace. Not all of this will need to be built in-house, and banks should be looking carefully at where third-party solutions can be purchased or invested in.

Taken together this could bolster revenues, while significantly driving down headcount and costs across the front office by 20-30% in impacted areas. However, this is a complex change program, and an area where regulatory scrutiny is likely to increase.

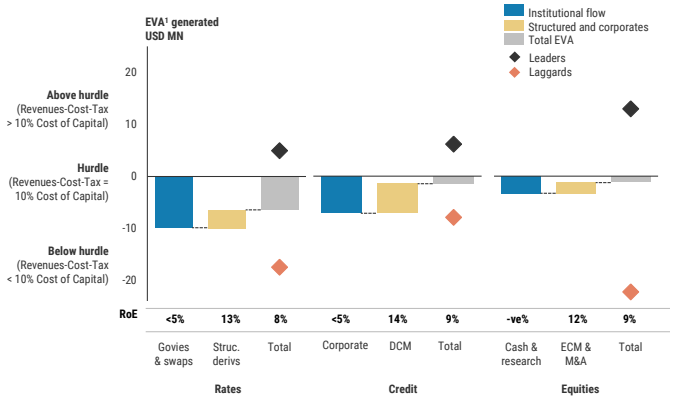
Traditional arguments that flow businesses sustain other profitable activities need to be challenged. Our analysis shows that more profitable revenue pools do not, on average, offset the drag from flow trading across all asset classes. In Rates trading, for example, every $100mn of revenues earned by the sell-side on average destroys $10mn of shareholder value, for an industry-wide RoE of 8%.

This is because above-hurdle returns earned in related structured and corporate businesses only offset one-third of the drag from government bond trading and institutional swaps. While there are some benefits to the structured business in maintaining a presence in flow markets, these need to be understood and challenged. In Equities, for instance, there are several examples of banks playing an active role in structured derivative trading without maintaining a presence in the underlying cash markets.

Exhibit 41:

Higher margins from most closely adjacent products are insufficient to compensate for returns on equity below cost of capital in institutional flow

EVA by product for industry average, leaders and laggards, EVA scaled per USD 100MN of revenue



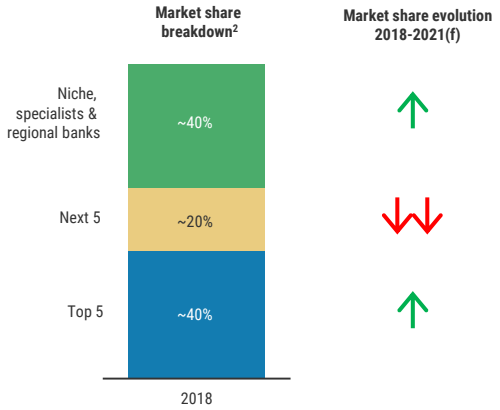
1. EVA calculated as revenue minus cost, minus tax, minus cost of capital. Cost of capital is calculated as 10% of average of 12.5% of RWA and 4.5% of Leverage

Source: Oliver Wyman analysis

Exhibit 42:

We expect sub-scale banks to lose market share to leaders and niche/ specialist players over the next three years

Sales and Trading[1] market share evolution, 2018-2021(f), %



1. Sales and trading includes Equities (Cash, Equity derivatives and Prime services) and FICC (G10 Rates, G10 FX, Emerging markets, Commodities, Credit and Securitization)

2. As a share of total industry revenues

Source: Oliver Wyman analysis, Coalition proprietary data

Creative capitulation and partnership models to outsource key front-office activities are likely to be more attractive to many. Several banks have already entered into arrangements to outsource activities such as pricing, market making and data analysis to a third party, bringing in world class capabilities while freeing up investment budget to support their ambition elsewhere. Common across these ventures is a recognition that traded markets are moving more towards very liquid products and electronic trading. Banks are often already behind the technology curve and as non-bank players continue to gain share in flow trading, it is harder for banks to extract value from market-making without significant investment in hardware, technology development and highly sought-after coding talent.

Despite these challenges, banks can draw considerable advantages from their client networks, particularly with corporates. This allows banks to retain a share of the economics, in return for their relationships, client-facing infrastructure and regulatory compliance. As banks focus on their areas of real advantage, we expect to see a growing number of such strategic partnerships.

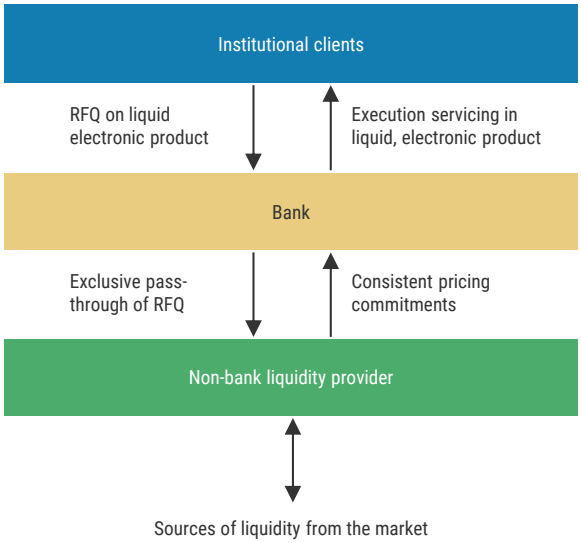
There are a range of live partnerships. Some of these are public, but many are not. We see five broad approaches to liquidity outsourcing and partnerships among which banks can choose. Propositions and trial runs exist across the Rates, FX, Credit and Equities businesses:

1. Non-bank liquidity providers (NBLPs) acting as an alternative liquidity source through an API or multi- dealer platform, but with the bank retaining its own capabilities
2. FinTech firms providing technology solutions to banks to improve real time resource allocation decisions to maximize P&L and client impacts
3. White labelling (either anonymous or disclosed) of market-making, potentially combined with pre-trade / post-trade analytics
4. Credit intermediation models where a non-bank provider furnishes market-making capabilities to a highly rated regional bank, with limited presence in a market but a large client base
5. Full outsourcing where all risk intermediation and market-making services are provided across a wide product set, likely with a joint platform

Exhibit 43:

Partnerships with electronic market makers on parts of liquid FICC are gaining momentum

Example simplified structure of partnership models



Source: Olive Wyman analysis

Each model has its own advantages and challenges. Banks need to look carefully at which model is best suited to their situation and the commercial structures needed to make the model work, including both financial and risk-focused structures. For in-sourcers to make this successful, they will need to prove themselves to be reliable counterparts and demonstrate early success once deployed.

Those that move early expose themselves to the greater risks, but also a bigger upside, as followers will have to spend time developing their own arrangements and may find that an increasingly small portion of the market is open to them.

A small number of banks with leading positions in individual markets will be able to dedicate the funds to compete and can combine elements of leading technology companies (either through partnerships or by behaving like them) with their own vast balance sheets to win. As well as just staying in the business, they should stay alert to opportunities to act as in-sourcers themselves, partnering with banks that have previously been competitors to add scale to their own platforms.

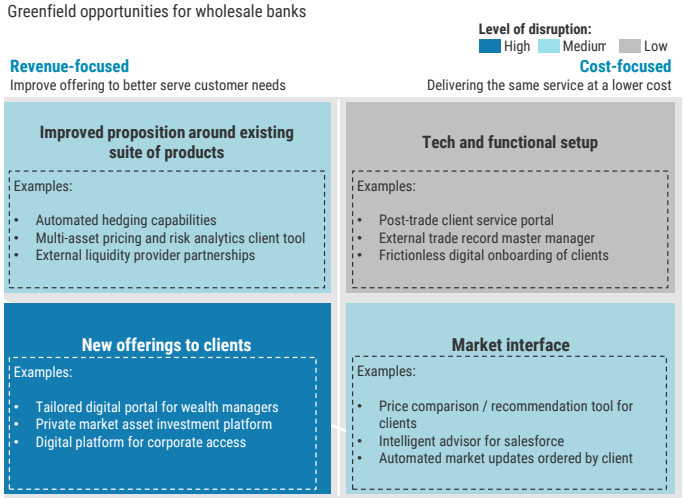
3. Growth and break-out solutions

To drive growth and step-changes in the cost structure, management teams also need to look for break-out solutions. This could mean opening up new revenue streams and growth markets or creating new ways of serving the same market in a radically lower cost structure. The best initiatives may do both at the same time, as we have seen from successful digital innovators in other industries. To pull off this kind of transformational change we expect banks to devote more investment spend and attention to greenfield business build approaches. By this we mean a business built away from the core, with brand new technology, entirely new organizations, and complete customer-centricity.

Exhibit 44:

Some banks will need to build an offering from scratch, separate from their existing infrastructure

Greenfield opportunities for wholesale banks



Source: Oliver Wyman analysis

Oliver Wyman's survey of Chief Information Officers (CIOs) points to the acceleration of an investment arms race. Budgets are being unlocked. Across the S&T industry we expect both global and regional banks to allocate an increasing share of their IT investment towards front office initiatives over the next three years. CIOs that responded to the survey expect investments in innovation, including greenfield, to grow from 10% of change spending in S&T divisions to 14% by 2021. Successful ventures will require intense collaboration between the front-office, risk and technology functions, and the capacity to scale rapidly once a successful hook is found. Oliver Wyman's survey was conducted in 2H2018 and comprised of 15 participating banks.

Corporate payments and cash management

Transaction banking, and particularly corporate payments and cash management, is the fastest growing segment of the CIB industry and a key battleground. Transaction banking revenues generated by corporates grew at 4% CAGR in 2018 and we expect this rate of growth to remain broadly stable out to 2021, despite the weaker economic outlook, as banks invest and find new ways to add value to relationships.

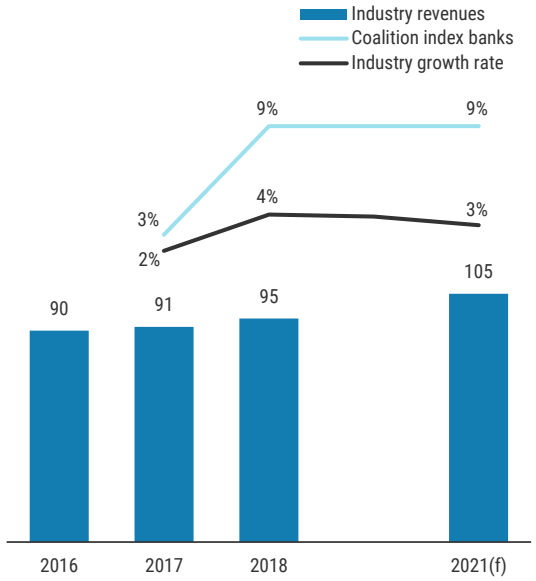
These businesses offer attractive returns on a standalone basis, and have relatively low marginal costs built upon largely scalable technology platforms. Added to this, transaction banking anchors many client relationships and provides high margin flows for S&T divisions, for instance in payments-linked FX.

In cash management, new client-facing propositions may dislodge large pools of revenues. The ability to run platforms at a fraction of the cost of legacy systems and re-orientate processes around customers in a way that existing offerings do not, will be a major competitive advantage for early movers. We estimate that by 2021 10% of revenues ($9-10bn) will be up for grabs, as customers respond to improved offerings. In an industry where even leaders only capture single digits of market share, this is a substantial opportunity.

Exhibit 45:

Corporate cash management will be a critical battleground

Transaction banking revenue pools and growth rate, 2016-2021(f), USD BN and %



Note: Coalition Index Banks includes BoAML, BARC, BNPP, CITI, DB, HSBC, JPM, SG, SCB and WFC. Includes cash management and trade finance for corporates with revenues over USD 1.5BN

Source: Oliver Wyman analysis, Coalition proprietary data

The largest banks enjoy a strong position of incumbency and we expect them to continue to capture market share. In 2018, the largest banks (ranked by corporate cash management revenues) grew revenues in transaction banking by 9%, twice the rate of the wider market. Large incumbents are well positioned to continue to outperform, driven by their existing and highly sticky client relationships, as well as the power of their greater investment capacity. But incumbents must guard against complacency, as a range of challenger institutions – banks and non-banks – are looking to attack the industry. New and aspiring competitors see an opportunity to increase the portion of the global CIB revenue pool in which they compete – either by expanding into new products, or into new regions.

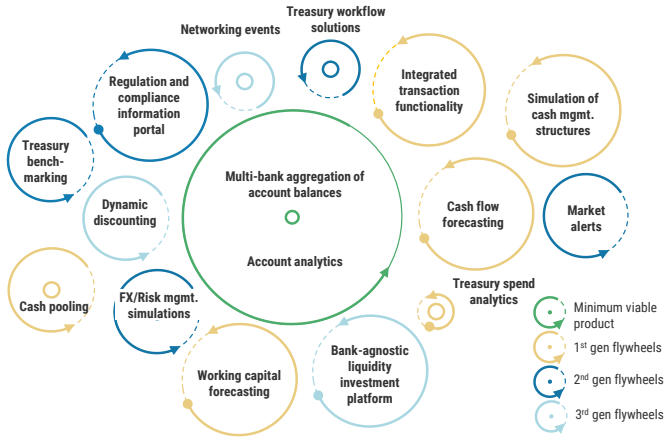
For slow movers, this influx of investment should be a concern. The ~10% of revenues that we estimate are most immediately at risk, could rise to up to 70% in the long term if incumbents fail to adapt and if changes in the market structure lead to widescale bank disintermediation.

Those that move early and fast will more than offset this pressure through increased client penetration and share. Winners will be those that dominate the customer interface with a differentiated technology led proposition, or those that develop a substantial cost advantage in individual parts of the value chain, such as payments processing.

Exhibit 46:

Growth will be driven by new propositions that solve problems for corporate treasurers

Flywheel growth occurs as new propositions are built around an initial minimum viable product



Source: Oliver Wyman analysis

There are also opportunities to reinvent the trade finance business, which is closely linked to the payments business. The most advanced banks, and those with the deepest client relationships, will be able to drive revenue growth by using new or transformed platforms as a springboard to launch tailored, sector-specific and ecosystem propositions. These solutions look to go beyond the traditional value-chain solutions (such as Supply Chain Finance) and instead connect a broader range of stakeholders operating in a given client ecosystem.

Emerging trade propositions are built on in-depth sector expertise, enabling banks to identify and address industry-specific pain points or frictions. This often includes tackling problems that have not traditionally been in the remit of corporate banks.

China

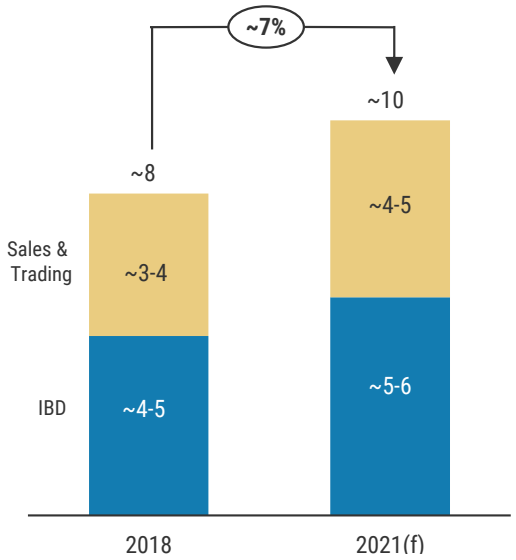
It is decision time for banks in China. The largest revenue pools will remain in the traditional corporate and transaction banking products. The biggest changes are coming in sales & trading and investment banking divisions, where a confluence of positive tailwinds are appearing, many of which stem from announcements at the 19th party congress, and reinforced at the 2018 Boao Forum:

- Growth of the onshore buy-side wallet driven by de-regulation of the asset management industry, shifts in funds towards institutional investors, and inclusion of China in key global indices (for example MSCI)
- Increasing issuer demand for capital markets products, supported by growing restrictions on the shadow banking industry and increases in institutional flows (for instance as insurers adapt to growing asset-liability mismatches)
- Shifting ownership rules for banks, making it a more accessible market for foreign banks than it has been previously been, and supporting growth in the local ecosystem
- Driven by the points above, a gradual relocation of sales desks and liquidity from Hong Kong to mainland China, partially reversing the trend seen over recent years

Exhibit 47:

Building a strategy to access growing onshore revenue pools in China

China onshore Sales & Trading and IBD revenue, 2018-2021(f), USD BN and % CAGR



Note: IBD includes onshore and offshore revenue pools, Sales & Trading includes onshore only

Source: Dealogic, Oliver Wyman analysis

We expect these to add ~$2bn of onshore revenues to the Chinese market by 2021, a growth rate of ~7% a year. For global banks that have the right licenses and ownership structures, there are pockets of near-term opportunities, for instance in margin financing and OTC derivatives. Sectoral expertise will also be a differentiator in serving the financing needs of MNCs operating in China, for example in DCM and securitization markets.

But the challenges are substantial, and the near-term revenue opportunity is insufficient to make an immediate return on investment. The market is already heavily competed and global banks, on average, only generate single-digit returns on equity. Local banks are investing and have strong foundations, notably in retail markets and onshore advisory. Furthermore, revenues will continue to be volatile and our conviction around the pace of growth is much higher over the +3 year window than it is over the near term.

As a result, business cases for global players increasing investment into China will have to be built around gaining the optionality and exposure to long-run growth as regulations ease and markets evolve. Real upside will only come as the market matures, for instance in A-share trading, and as the effects of regulatory changes kick in.

A growing group of banks will double down. The investments required are substantial and will force sacrifices to be made in other regions and business lines to fund this investment. Sub-scale European entities could lose out as a result. We estimate that industry wide there is $50bn of excess capital deployed to CIB divisions in EMEA versus the revenue opportunity. As a result, a knock-on impact of the growing attractiveness of China could be increased scrutiny over incremental investments in post-Brexit entities across both the UK and the EU.

In response to foreign competition, we are seeing local Chinese banks build out their capabilities. They benefit from strong starting positions and are better-placed than most international banks to support low returns for a potentially long period of time.

Growth in domestic markets may eventually embolden them to pursue longstanding ambitions to venture into international markets. New potential business models make this more attractive as these banks have the option to be much more selective in their participation choices as they enter foreign markets, for instance by focusing on RMB and Chinese-originated securities, while partnering with third parties to access liquidity in other asset classes.

New propositions with institutional clients

Serving institutional clients is increasingly challenging – banks need to find new propositions to improve the economics. Revenues are growing at approximately one quarter of the corporate wallet and are much less economically attractive, particularly for smaller banks. Banks with capital to deploy can still find growth in areas such as prime services, equity derivatives and portfolio trades, but will be highly competitive, especially if activities continue to be directed towards leaders.

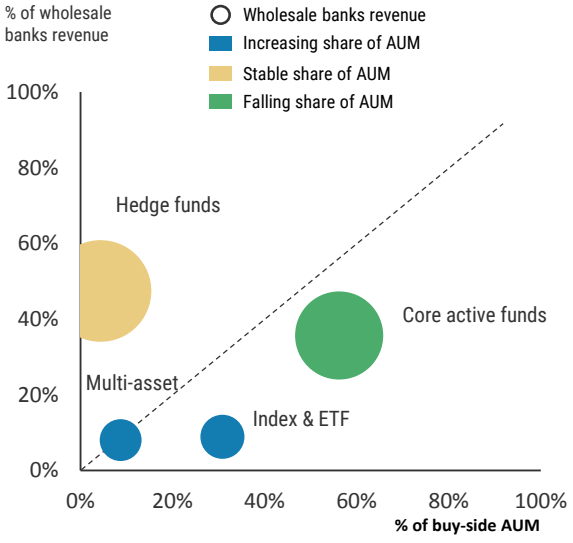
Much of the pressure is coming from structural changes in the buy-side itself. We estimate ~85% of sell-side revenues earned by sales & trading divisions from trading with the buy-side comes from hedge fund and active asset managers. This compares to just ~9% generated from ETF and index products, despite them managing over one-quarter of industry AUM. MiFID II has increased the pressure on banks in Europe. Most directly it has eroded ~$1-2bn from revenues in cash equities, which was already a loss-making business for many (typically smaller) banks. But it has also changed market structures across S&T, increasing transparency and providing more scope for disruptive firms to rapidly gain share with ultra-low-cost offerings.

To replace these lost revenues, banks need to shift the way they think about their role with the buy-side. Full service banks could look to increase outsourcing for their asset manager clients in activities that are expensive and provide little competitive differentiation, such as regulatory reporting. Elsewhere, banks that build capabilities to help asset managers or end investors gain exposure to alpha returns will be rewarded. Private markets, which we expect to grow to over 20% of buy-side revenues by 2021, are an obvious target. Banks could go direct to market, for instance with direct-to-customer digital platforms, or they could leverage their corporate or wealth manager divisions to source these assets for investors. Combined, we estimate there are $3-5bn of potential new revenue pools across Markets and Investor Services businesses out to 2021 through a rapid expansion of services.

Exhibit 48:

We estimate ~85% of sell-side revenues earned by Sales & Trading divisions from trading with the buy-side comes from hedge funds and active asset managers

Buy-side AUM (%), and % of S&T revenues from buy-side clients, 2018 by fund structure



Note: Excludes private markets

Source: Oliver Wyman analysis

4. Conclusion

The revenue environment and competitive outlook for CIBs will force banks to act, as growth becomes harder to come by. The optimism of 2018 has been tempered, and, for many of the banks with the weakest starting points, it has been replaced by concern. CEOs and investors are having to look harder and further out in time to find new revenue growth and break-out opportunities. This, in turn, has required management to reconsider how they can restructure their core businesses.

For banks that have led with the deepest cuts in front-office headcount, it is now time to look for more profound restructuring of corporate centre and service provider costs. Beyond this, banks need to explore ways to creatively capitulate in markets where they have little hope of winning, and they should combine this with investments in new ways of running the businesses to which they remain committed. We believe that by being laser-focused on these areas, and leveraging third parties, a compelling investor narrative can be built. But decisive action will be needed to make this shift and we think banks need to be more open to exiting areas where they have little chance of success to allow them to win elsewhere.

In contrast, US banks and a small number of regional leaders, are in a stronger position and have a greater degree of freedom to adapt their business models and build for growth. This resilient investment capacity for longer-term projects will allow them to pursue a range of strategic options – from bets on disruptive technology, such as through greenfield initiatives, to building new client platforms. They will need to gain efficiencies and augment their leadership positions. But far from looking to reduce their pool of unprofitable clients, the goal for many of the most ambitious banks in 2019-21 will be to expand their addressable market and increase the scale of their global client franchises.

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