McKinsey & Company

European Private Banking Survey update: December 2020

Global Banking Practice

Private banking profits fell in the second and third quarters, despite a strong market recovery.

December 2020

McKinsey's latest European private banking survey shows a decline in profitability of around 11 percent in the second and third quarters compared to the first quarter of 2020. As a result, the annualized average profit projection for private banks was roughly €12.6 billion in the second and third quarters, down from €14.2 billion in the first quarter of 2020 and €13.2 billion figure for full-year 2019 (Exhibit 1, next page). As the pandemic spread, the industry's profits declined, following a sharp rise in the early part of the year driven by increased volatility, which led to higher trading volumes.

Compared to the first quarter of 2020, assets under management (AUM) grew by 8 percent in the second and third quarters—reflecting an equity market bounce from March lows. Revenues dropped 7 percent to an annualized €43 billion and costs declined 5 percent to annualized €31 billion. Projections for full-year 2020 are for a third consecutive year of revenue declines despite consistently rising AUM, and for the first drop in costs since 2010.

Despite strong AUM growth over the summer, the European private banking industry struggled to attract new assets in the second and third quarters, with net AUM flows amounting to 1 percent. Revenue margins resumed their decline in the second and third quarters after improvement in first quarter, contracting by approximately 4 basis points (bps) from the first quarter 2020 to reach 72 bps of AUM, the lowest levels since we started the survey in 2002. The revenue decline was driven by a decrease in lending penetration of 1 percentage point and a drop of 3 percentage points in brokerage fees, and by a reduction in deposit and lending margins of 2 bps and 1 bps respectively, compared to the first quarter 2020, despite a modest shift from cash to equities. Advisory and discretionary mandate penetration rose by 1 percentage point each to reach 20 percent and 29 percent respectively. The result is that the industry's share of recurring fees rose by 2 percentage points compared to the first quarter 2020. Cost margins declined by about 2 bps to 51 bps of AUM compared to the first quarter 2020, amid COVID-19-related disruptions in activities such as travel and entertainment. In parallel, profit margins fell to 21 bps of AUM, only slightly better than the 20 bps in 2009—the lowest ever recorded.

Despite challenging second and third quarters, the majority of firms participating in our survey anticipate a muted impact from COVID-19 on their full-year AUM, with net inflows of 0 to 2 percent and 0 to 5 percent of market performance impact. In addition, they expect revenue pools to decline by 5 to 10 percent for 2020 compared to 2019, and a cost reduction of

0 to 5 percent for the full year. All participants expect normal operations to resume by June 2021, assuming lower virus transmission rates, vaccine rollouts, and reduced capital markets volatility. Private banks have focused recent efforts on activating contingency cost reductions, enabling relationship managers to work remotely, and developing new products and digital functionalities. On the strategic agenda, organic growth remains a top priority, with cost reduction second (compared to eighth at the end of 2019).

In our July 2020 survey update, we articulated three strategic priorities that could help banks prepare for the next normal, and these remain unchanged: 1) deliver a remarkable client experience powered by technology; 2) reconfigure the operating model, and; 3) inject purpose into business choices.

Recent experience has shown that private banking's performance is highly contingent on external factors and market volatility. However, even a market recovery may not resolve all of the industry's challenges, amid persistently lower interest rates and potentially longer-term changes—including remote working and travel restrictions—that may hinder net inflows and revenue growth. In a dynamic environment, banks must become more resilient, focusing on revenue generation and cost management, and balancing short-term measures with longer-term transformations. We propose the following priorities across front and middle/back offices (Exhibit 2, next page):

Front office

To grow net new money against the backdrop of 13 years of continuous revenue margin pressure, private banks can take the following actions:

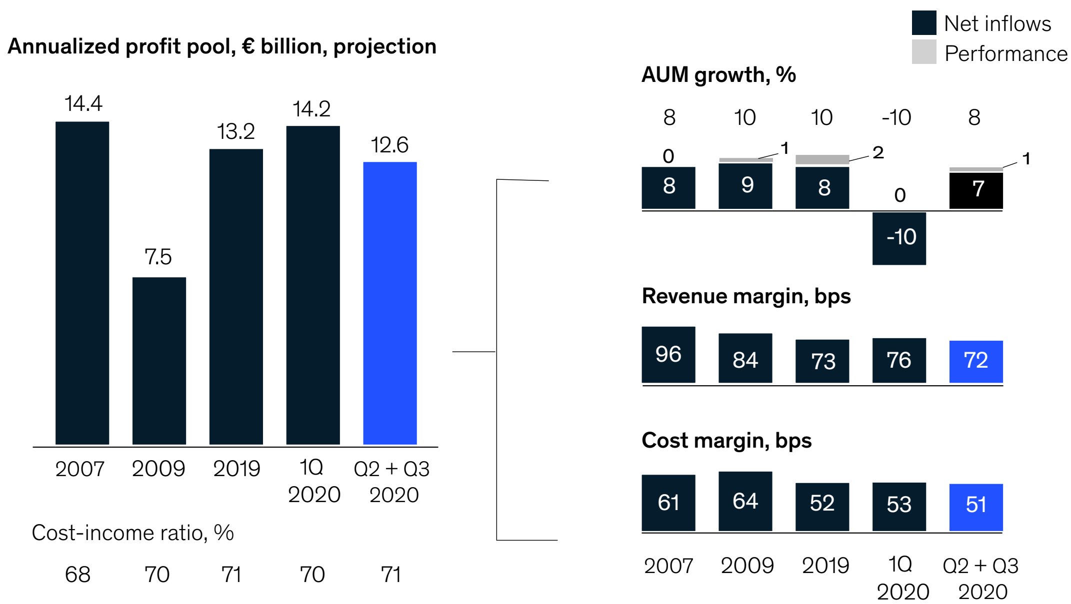
1. *Sharpen their value propositions* and offer distinctive products and services that are aligned with clients' needs and investment goals. They can develop a competitive edge, for example, by: expanding ESG propositions to reflect increasing awareness about climate change; increase lending to help clients finance their businesses; offer absolute-return products for retirement planning and customized goal-based investing beyond the classic income, balanced, and growth investment profiles; and develop private investments for yield-seeking strategies.

2. *Embrace technology* to enable relationship managers to engage with clients remotely and offer a superior customer experience across all segments and channels. Powerful levers include digital sales tools and management, automatic assembly of key information and year-end documents, video conferencing tools, analytics-led referrals, and digital marketing capabilities for client acquisition.

3. *Maximize sales productivity* through virtual sales training and effective playbooks for relationship managers. Banks should swiftly adjust structures, processes, and organizational frameworks to fully

Exhibit 1

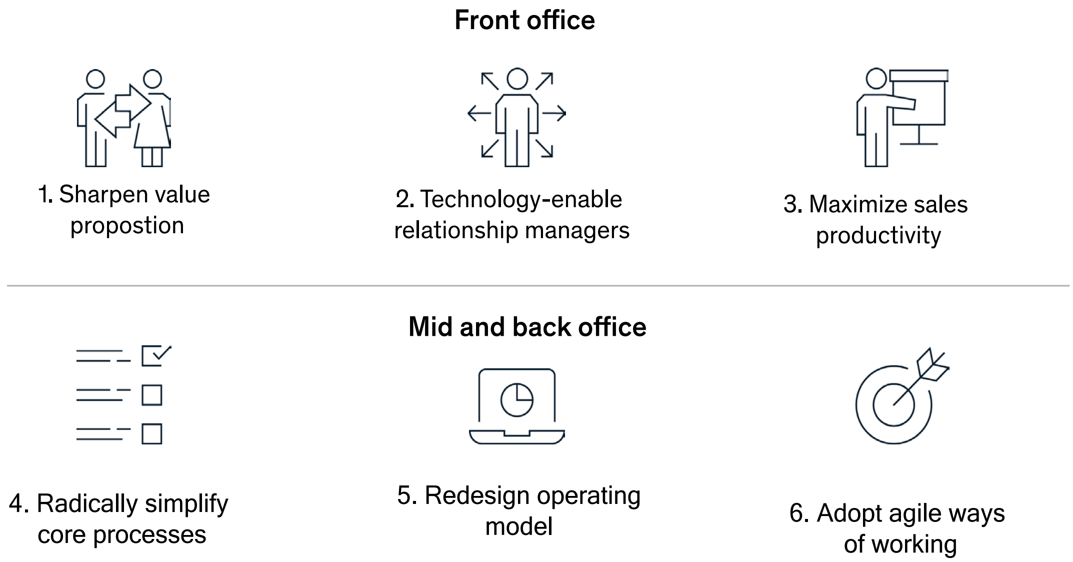
Despite strong AUM growth, projected European private banking profit pool contracted in Q2 and Q3 2020.



Note: Profit pool, revenue and cost margins for Q1 and Q2/Q3 are annualized.
Source: Annual reporting; McKinsey Private Banking Survey

Exhibit 2

Steps toward a faster transition to a resilient operating model.



Source: McKinsey

support RMs in engaging with clients effectively in a remote and digital environment.

Middle and back office
To fundamentally re-size cost bases, and become leaner and more flexible, banks can take the following steps:

4. *Radically simplify core processes,* reduce demand and duplication, harmonize procedures, enable rapid automation, and digitize the five to ten most important processes.

5. *Redesign the operating model,* accelerating the move to cloud-based applications (rather than remaining on proprietary stacks), redeploying and reskilling employees, and driving front-to-back transformation.

6. *Adopt agile ways of working,* which will increase flexibility and raise "metabolic rates." To support growth, private banks can also simplify governance frameworks by assigning clear responsibilities and speeding up resource allocation.

The full results of McKinsey's 2020 private banking survey will be published in summer 2021 and will include a discussion of operating models.

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Introducing an industry-first fully digital interface for survey access
McKinsey's global WAM practice has launched Wealth & Asset Management Insights (WAMInsights)—a data, analytics, and insights portal that provides cutting-edge industry intelligence. In the 2021 edition of our private banking survey report, we will present insights on our private banking and asset management benchmarking surveys. The results will be published on the platform, enabling participants to access information using a dynamic interface and with flexibility to choose peers, years, and drill downs on specific metrics. For more information, please contact us at *private_banking_survey@mckinsey.com.*