

## Wealth Management January 2009

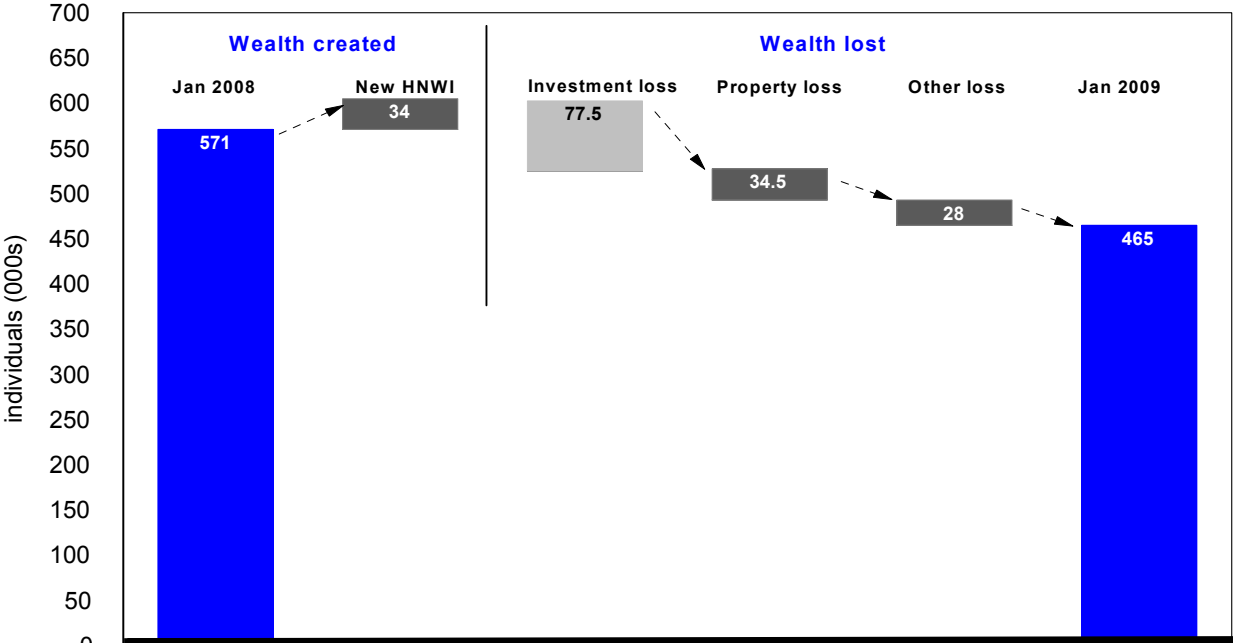
### UK High Net Worth 2009 (Brief abstract)

This is a brief abstract from MDRC's 11<sup>th</sup> annual report on the UK High Net Worth (HNW) sector. In previous years the objective of the report has been to give a broad view of the market and the key issues impacting high net worth individuals. This report is rather different, although we do present the key market metrics, our aim this year is to provide an understanding of the drivers of market size and growth. We also touch on some of the key issues impacting the HNW sector and those businesses involved in serving the UK's wealthiest individuals.

The full report will be published in February 2009

Summary	
1.	The number of UK HNW individuals fell by 19% to 465,000 in January 2009 and their assets fell by 17%
2.	The number of UHNW individuals (with more than £5m in free assets) fell by 31% and their financial assets fell by 33%
3.	2009 growth will be in the range -3.5% to +2.0%, but with -1.0% to -1.5% as the most probable outcome
4.	The contraction of property development and financial services will delay recovery of the UK market to beyond 2010

Dynamics of the UK HNW market



Source: MDRC analysis, S2W group, Pinnacle

## UK HNW 2009 - Introduction

### **2009 will be a challenging year for those businesses dependent on the UK HNW sector:**

Firstly, the dynamics of the sector have undergone a significant change since September 2008, not only in size and value, but also in the drivers that have been responsible for remarkable growth in the sector in recent years. Our analysis shows that since 1996 over 60% of HNW growth has been driven by property development and sophisticated financial services ("The City"), and activity in both of these 2 drivers will be subdued for the medium term. The projected loss of some 15,000 managerial level investment banking jobs will slow the recovery of the HNW sector.

Secondly, HNW attitude to investing has altered dramatically. Although most investors accept the concept of "Risk and return", very few understand the impact of market volatility on their wealth or that "low risk" does not mean "no risk". The attitudinal changes we have observed are so significant that we have revised our behavioral segmentation model to accommodate the emergence of a new type of HNW individual – "The Disillusioned".

We also expect to see the continuing evolution of the HNW individual; now more financially wary, prepared to question the "experts" and even more risk averse than in recent years. However, these individuals remain time constrained and keen to protect their lifestyles, particularly in retirement. 2009 will probably see a continuation of the shift in the financial priorities of the "average" HNW individual; consumption of financial assets will decline as an "austerity" mentality takes hold.

Inevitably, there will be winners and losers in the wealth management industry. Our research points to a decrease in the "Traditional" type of wealthy individual who is content to have his or her financial assets managed at arms length. In 2009 the majority of the HNW want to have a degree of control over their wealth. As a consequence maintaining client profitability and re-building assets bases will be major challenges in 2009. Although some UK wealth managers are embracing the changes and developing new products, services

and delivery mechanisms, too many wealth management businesses are pursuing business models that were developed a decade ago. How well these firms adapt to the new competitive climate remains to be seen.

Finally, it is disappointing that despite assurances from the government that UK economic growth in recent years was entirely sustainable, a report from HM Treasury "**2008 Pre-Budget Report: the economy and public finances –supplementary material**" revealed that the government had allowed the economy to expand at an unsustainable rate since 2005. There is no doubt the crisis that followed the collapse of Lehman Bros came as an economic shock, but the view that the UK economy was basically untroubled up to that point is not credible given the Treasury's own figures.

Given the data now available we have re-assessed our planning models. Our 2009 planning scenarios show that for the next 2 years the UK's HNW sector will experience little or no growth and it is highly likely that the sector may decline further in 2009. Our research suggests that investment portfolio valuations do not yet fully reflect the losses incurred in Q4 2008, particularly in products with "constrained" assets. Another uncertainty is the "Buy-to-let" segment of the property market where the full impact of the fall in asset values has yet to be felt by the HNW sector.

We hope that this report will provide those businesses with an interest in the UK HNW sector with a credible model by which they can test their strategies and those of their competitors, and trust that it will help firms better serve the needs of industry stakeholders.

Richard Williams  
Managing Director

## Summary of Key Findings

### Market Dimensions

- Our research suggests that the number of UK HNW individuals fell by 106,000 in 2008 to 465,000 in January 2009. This 19% fall was the largest annual decline in HNW numbers since 1980. The financial assets held by these individuals fell by 17%
  - There was a gross decline of 140,000 individuals, offset by around 34,000 new HNW individuals. Exposure to the property sector – particularly “Buy to let” – resulted in substantial asset losses for approximately 34,500 HNW individuals in 2008, with losses in this sector set to continue in 2009.
  - The affluent market fared better and numbers only fell by 11% to 1.66m; in contrast the number of UHNW individuals (with more than £5m in free assets) fell by 31% and their financial assets fell by 33%.
  - There will be little or no market growth in 2009, and it is possible that the segment will contract further as the full extent of exposure to financial products linked to Lehman Bros, AIG and Madoff Securities (and possibly others?) comes to light, and the UK “Buy to let” sector falls further. The sharp contraction of employment in investment banking and related areas of financial services will increase the downward pressure on the sector.
  - Capital conservation has become a priority for the majority of the HNW sector. HNW individuals have significantly reduced their expenditure on large, discretionary capital items – particularly luxury cars, large yachts and powerboats.
  - Our planning scenarios suggest that the HNW sector may return to modest growth in 2010 but will not fully recover until 2012 or beyond.
- unlikely to recover to pre-2008 levels in the short term. In particular, individual wealth creation from investment and related banking in London may never fully recover to pre-2008 levels.
- The behavioural characteristics of the HNW market have changed substantially. The sector has evolved into the 5 “D”s - Disillusioned, Dependent, self – Directed, Disengaged and Demanding.
  - There has been as sharp reversal of fortune for the entrepreneur segment. After 2 years of rapid growth the wealth of UK’s entrepreneurs has seen the sharpest fall, while “old”, multi-generation wealth has seen the lowest decline.
  - HNW investors are increasingly concerned about the “opacity” of many financial products recommended by wealth managers. “Fund of funds” and “Manager of manager” products now give investors particular concern.
  - In response to market uncertainties, there has been a flight to safety. The HNW have moved assets into, or intend to move assets into:
    - cash
    - structured products where there is a substantial element of capital guarantee
    - government or high quality corporate bonds with a longer maturity, and
    - income and money market funds,
  - Sentiment has also turned against hedge funds with 83% of “sophisticated” HNW investors expressing concern at the level of their portfolios invested in these products. In contrast, interest in private equity investment remains high with 43% of “sophisticated” HNW investors intending to increase their private equity holdings in the next 18-24 months.
  - There is substantial concern about the security of financial institutions with 78% of HNW individuals choosing to move assets between financial institutions to reduce their exposure to corporate failure .

### Market developments

- The UK’s 2 key drivers of HNW sector wealth – sophisticated financial services and property development have both contracted sharply and are

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## Summary of Key Findings (cont)

### Wealth management industry challenges

wealth advisory arms of accountancy or law firms.

- Although some firms maintained close contact with their client bases during the period of market collapse in the autumn of 2008, our research shows that the majority of firms did not live up to their clients' expectations of service delivery – let alone investment performance. Rebuilding client confidence is a priority.
- The most successful wealth management firms in the current down turn will be those that offer clients a wide range of service options and flexibility in relationship and delivery design. Firms that maintain a rigid product or service model will be unable to maintain client relationships as the HNW sector evolves over the next 2-3 years. The most successful wealth management firms will align their business strategies to managing and developing the client relationship and adapt rapidly to the changing business environment.
- Income derived from *ad valorem* fees on assets under management will remain under pressure. Those firms demonstrating better than benchmark performance will be able to sustain fee structures, however firms that have performed badly are likely to suffer asset outflows or fee erosion (or both).
- Client profitability will again become a challenge. After 3 years of extremely strong performance, the sector will face the need to understand client profitability and the levers available to improve profit levels.
- HNW behaviour has undergone a radical transformation with increasing numbers of HNW individuals seeking to exercise some control on the management of their assets. Firms that offer some element of on-going client input will be able to acquire more clients than those with a single discretionary management service.
- Independent Financial professionals remain the first choice for HNW individuals seeking financial advice, not only IFAs but in particular the

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## About MDRC

**MDRC** is a management consulting firm and a leading advisor on wealth management and private banking business strategy. From offices in London, St Peter Port, Weybridge and Zurich, we help clients in all sectors of financial services across the EU and the Middle East to gain a better understanding of their target markets, identify highest-value opportunities, benchmark their performance and improve the way they work.

### **Creating an Impact - Innovation & Sustainable Advantage**

We help our clients build a sustainable competitive advantage by focusing on the core skills of client management, marketing strategy, operating structure, product and corporate development. We assist firms to innovate and grow through finding opportunities in mergers & acquisitions. Our approach to consulting combines deep insight into the dynamics of business organisations and unrivalled knowledge of the wealth management and private banking markets. **MDRC's** associates cover all 27 states of the EU and the world's major financial centres.

### **Understanding Consequences - Strategic Research**

**MDRC's** strengths come from our investment in strategic research. Each year **MDRC** group commissions strategic research into the key issues relevant to the world's wealth markets to stay relevant to our clients and bring them unparalleled thinking and advice. The MIDAS model developed by **MDRC** gives a comprehensive analysis of individual wealth in 25 countries of the EU and the world's major economies. The 6 million data items covering demographic and behavioural analysis, portfolio composition and sources and uses of wealth, allows **MDRC** and our clients to build an accurate view of market and segment sizes, current client needs and future market trends.

### **Committed to success and value - Business Planning**

We believe that consultants should only provide business managers the support they require. If this means that assignments are focused on validating or challenging business assumptions and plans rather than "re-inventing the wheel" we are happy to work on that basis. Our Business Planning team works on short projects to give clients an independent assessment of current business plans and objectives. We focus on facilitating the strategic and business planning process; we support businesses to develop robust strategies and we test existing plans against our market knowledge and planning scenarios.

### **Building Reliability - Improving Client Relationships**

We are committed to assisting our clients in understanding and improving their client relationships and expand their client bases. A key element of our proprietary research focuses on the potential of the client relationship and the performance of organisations in meeting clients' needs and expectations. Over the past 10 years we have developed robust methodologies to measure and improve client satisfaction and in service sector businesses.

### **Building an Effective Organisation - the Position Assessment**

The foundation for building a more competitive and effective organisation is to understand the strengths and weaknesses of that organisation and those of their competitors; when this is carried out with a structured methodology we call this a "Position Assessment".

Working with each client, we develop new insights about the business and the market, assist the business to act and drive tangible results, and become more capable.

#### **Disclaimer**

This research report has been prepared for general circulation to promote discussion of the future of the Affluent and HNW markets. The information contained in this report is believed to be correct at the time of publication. The findings, observations, conclusions and recommendations have been based on data gathered from both primary and secondary sources and although we have sought to confirm and cross-reference the data wherever possible we do not guarantee its accuracy or completeness. MDRC cannot accept any liability for any action taken or decision based on any statement in the report.

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