Focus on Wealth Management: Tax Transparency and Cross-Border Activity

Greater tax transparency and the increasingly global scope of the automatic exchange of information (AEOI) have negatively impacted the volume of international wealth management activity. We take the view, nevertheless, that cross-border activity will remain important as high net worth individuals (HNWIs) continue to see the benefits of globally diversifying their wealth. We further expect affected financial institutions to have made good progress in adapting their systems and processes to deal with the operating, legal, and strategic and commercial impacts.

Addressing international tax evasion

Over the last decade, there has been continued advances in policies to increase international co-operation in tax matters and tax transparency. In 2003, the first multi-national AEOI programme was adopted, the EU Savings Directive. This was followed in 2010 by the US Foreign Account Tax Compliance Act (FATCA). In September 2014, the OECD (Organisation for Economic Co-operation and Development) developed a global AEOI standard, the Common Reporting Standard (CRS) which was endorsed by the G20. Nearly 100 jurisdictions have committed to implementing the CRS by 2017 or 2018.

Implementation within Europe

In December 2014, the EU adopted the CRS by amending the Directive on Administrative Cooperation. Under the directive, member states were required, from 1 January 2016, to provide financial account information such as investment income (including interest, dividends and income from certain insurance contracts), account balances and sales proceeds from financial assets to the tax authorities of other member states. The first automatic exchange of this information between member states will occur by 30 September 2017.

In Switzerland, the automatic exchange of information with EU member states and others, including Australia, Canada and Norway is due to enter into force on 1 January 2017 with the first exchange of data expected to take place in 2018.

CRS is not the same as FATCA

The CRS contains the reporting and due diligence requirements that form the foundation of AEOI. Financial institutions (including banks, asset managers, investment funds and insurance companies) must report financial account information on their clients that are tax residents in other participating jurisdictions.

CRS, while based on FATCA, is meaningfully different as it is intended to identify and report the financial account information not only of US persons. Further, CRS does not include the minimum USD 50,000 threshold meaning that all accounts are subject to review and potential reporting. CRS has over 80 data elements of which 17 are unique to CRS and only 36% of the elements have the same definition under FATCA.[1] Meanwhile, both systems entail due diligence on new and pre-existing accounts held by individuals and entities.

To provide a very rough idea of the volume of information that may need to be collected, we point to the fact that there are at least 15 million foreigners working in the EU – of which 8.5 million were third-country nationals.[2] It would not be unreasonable to assume that these people held financial accounts in their home country and therefore an exchange of account information may be required.

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[1] Ernst & Young. "Automatic exchange of information: the challenges to get it right." January 2015
[2] Eurostat. "EU citizenship – statistics on cross-border activities." April 2013

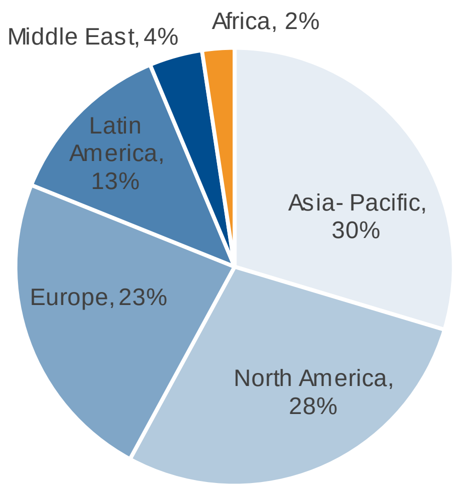
Impact on cross-border wealth management activity

AEOI and greater tax transparency have negatively impacted international wealth management market volume, with some clients repatriating their wealth and returning to domestic wealth managers. As well, client wealth has been reduced by tax regularisation (e.g. due to treaties between the country of domicile and the resident country of the wealth manager).

However, cross-border wealth management is expected to remain important in the future as HNWIs continue to see the benefits of diversifying their wealth globally and to value the expertise of leading wealth managers – although less so than in the past. Moreover, wealth managers are focused on growing in foreign markets where clients have repatriated assets.

In 2015, the Asia-Pacific region became the largest HNWI wealth market, ahead of North America for the first time (Figure 1). In the region, both the number of HNWIs and the amount of wealth increased by more than 9%; essentially the same level of annualised growth as seen in the period 2010 to 2014[3]. It is not surprising that leading wealth managers which still tend to be European and North American have been targeting the opportunities in Asia-Pacific.

Figure 1: Distribution of HNWI wealth by region

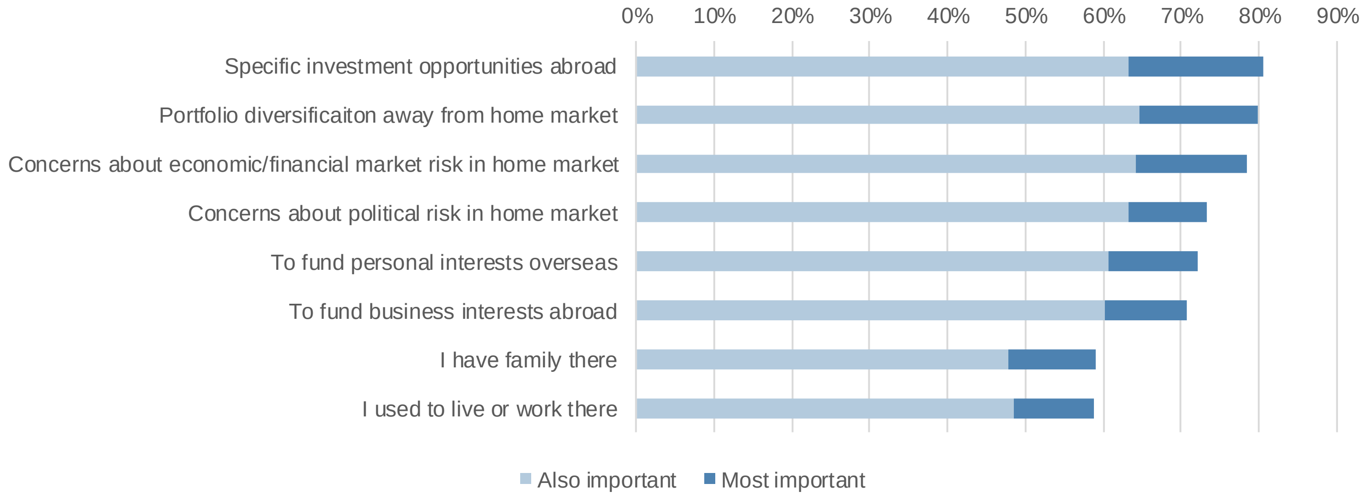


Source: Capgemini World Wealth Report 2016

From the client's perspective, cited reasons for holding assets and accounts outside of their home country include access to specific products and services, political and regulatory stability and geographical diversification – especially for global and mobile clients with assets spread over many countries (Figure 2). In Capgemini's 2016 HNW Insights Survey which surveyed over 5,200 HNWIs in 23 countries, nearly 55% of respondents globally held assets or accounts outside of their home country.

[3] Capgemini World Wealth Report 2016

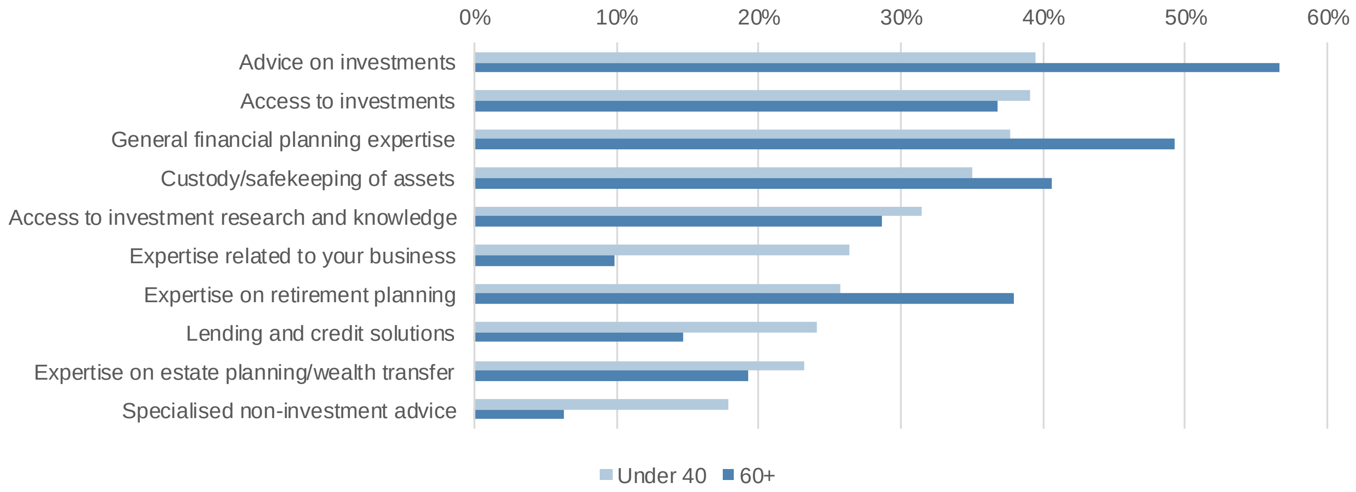
Figure 2: Most important reasons to hold accounts/assets outside of home country (%)



Note: Question asked – What are your main reasons for holding assets or accounts outside of your home country?
Source: Capgemini Global HNW Insights Survey 1Q 2016.

These responses highlight the need for wealth managers to tailor their products and services to the needs of cross-border clients; service quality and discretion are no longer sufficient.

Figure 3: Most important elements for choosing a wealth management provider, by age (%)

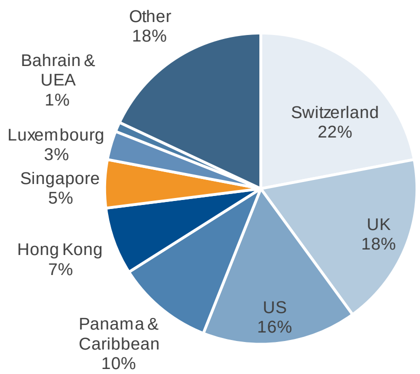


Note: Question asked – Which of the following elements of the proposition were MOST IMPORTANT to you when you chose to begin a relationship with your wealth management provider?
Source: Capgemini Global HNW Insights Survey 1Q 2016.

Leading wealth managers

Available data suggests that while global wealth is increasing, not all of the new wealth is being booked in international wealth management centres. Separating international market volume between new net asset flows and the effects of capital market performance and foreign exchange reveals that most centres have struggled to attract net new assets in recent years.

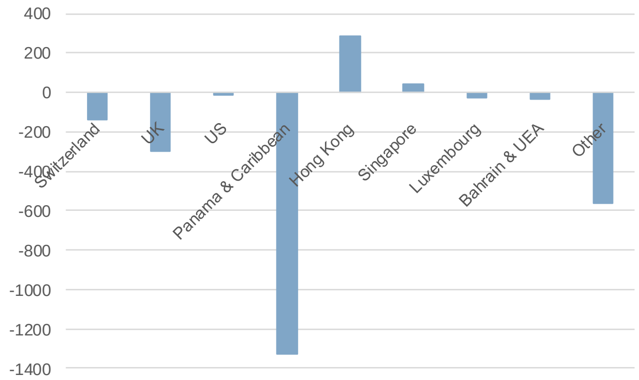
Figure 4: International private client market volume by wealth management centre



Note: Data as of 2014. Other = Austria, Belgium, Channel Islands, Germany, Ireland, Liechtenstein, Monaco.

Source: Deloitte Wealth Management

Figure 5: Net new asset flows by wealth management centre (USD bn, 2009-2014)



Note: Other = Austria, Belgium, Channel Islands, Germany, Ireland, Liechtenstein, Monaco.

Source: Deloitte Wealth Management

Data on individual wealth managers from the Scorpio Partnership shows a more nuanced picture (Figure 6)[4]. In 2015, the world's 25 largest private banks managed just over 56% of the approximately USD 11 trillion global HNW market's assets under management (AUM). While the top 25 banks saw average net new money growth of over 30%, AUM actually declined by an average of 1.7% due to market volatility and some restructuring of divisional reporting lines at certain banks.

Meanwhile, average operating profit fell by 4.7% from 2014 and the average cost income ratio was 75.1%, which was better than the industry average of 80%. Costs remain high in part due to new regulatory requirements and the investments needed to modernise the business in areas such as customer experience, digitalisation and analytics.

[4] Scorpio Partnership. Global Private Banking Benchmark Report 2016.

Figure 6: Selected leading wealth managers worldwide by AUM

Global Ranking	Institution	AUM YE2015 (USD bn)	Reporting currency	YoY growth in AUM (reporting currency) 2015
1	UBS	1,738	CHF	-0.5%
2	Bank of America Merrill Lynch	1,445	USD	-2.1%
3	Morgan Stanley	1,439	USD	-2.8%
4	Credit Suisse	687	CHF	-7.1%
5	Royal Bank of Canada	621	CAD	5.1%
6	Citi	509	USD	-7.6%
7	JP Morgan	437	USD	2.1%
8	Goldman Sachs	369	USD	1.7%
9	BNP Paribas	357	EUR	6.2%
10	Deutsche Bank	311	EUR	3.6%
13	HSBC	261	USD	-5.1%
18	Santander	205	EUR	5.7%
22	Credit Agricole	165	EUR	7.1%

Source: Scorpio Partnership. Global Private Banking Benchmark Report 2016.

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