The future of private banking in Europe: Preparing for accelerated change

MCKINSEY EUROPEAN PRIVATE BANKING SURVEY

European private banks were already feeling pressure to revitalize. Now that the pandemic has accelerated changes in the expectations of clients and employees, the industry will need to accelerate its transformation.
European private banks met COVID-19 in a difficult starting position, following a second year of declining profits, according to McKinsey’s 2020 Private Banking Survey. Despite soaring markets in 2019, the profit pool fell to €13.3 billion for the year, from €13.5 billion in 2018.

To get an initial read of the pandemic’s effects on the industry, we extended our survey into first quarter performance in 2020. The industry managed a strong start to the year, due to high COVID-19-induced trading volumes, but private banks face three enormous new challenges: pressures on revenues and profits from the uncertainties related to COVID-19; an acceleration in client demand for digitally enabled remote engagement; and a shift toward remote working. The pandemic has also brought client relationships into sharper focus: In highly uncertain times, clients place greater reliance on their advisors, who need to respond with their best insights.

Prior to the emergence of COVID-19, private banks were already feeling pressure to revitalize, but the pandemic has accelerated changes in the expectations of clients and employees. The combination of these trends will require the industry to accelerate its transformation.

A decade of profitability erosion and limited action
Globally, private banks retained their position as the most profitable segment in banking in 2019. But that success has limits: 2019’s results confirmed a decade-long trend of compression in profit and revenue margins, costs rising faster than revenues, and rising cost-to-income (C/I) ratios. Thus, in spite of further growth in assets under management (AUM) from soaring markets, profits declined for a second consecutive year.

Private banking profit pools in Western Europe fell 1.5 percent to €13.3 billion for 2019, down from €13.5 billion in the year prior (Exhibit 1). At the same time, the aggregate profit margin fell to a 12-year low of 21 bps of AUM—down from 22 bps in 2018, and 35 bps in 2007.

Growth through net inflows continues to be elusive for the region’s private banks, despite growing wealth. Net inflows in 2019 matched 2018 at 2 percent of AUM, although favorable markets allowed overall AUM growth of 10 percent. Between 2015 and 2019, new inflows were positive but relatively low, averaging 2.5 percent of AUM versus the average 5.8 percent realized between 2004 and 2008. If market performance since 2007 had been flat, and AUM growth limited to net inflows, profit pools would have fallen by an estimated 18 percent through 2019, versus the actual 8 percent drop.

Revenue margins continued their downward trend, slipping to a 12-year low of 73 bps of AUM, compared to 75 bps in 2018 (and well down from the 96 bps of 2007). Between 2015 and 2019, revenue margins fell from 81 bps to 73 bps due to the AUM shift towards the lower-margin ultra-high net worth segment (clients with AUM greater than €10 million), compression in discretionary and advisory mandate margins, and the lower-for-even-longer interest rate environment as the share of cash remained high at 30 percent.

Overall costs continued to grow in line with revenues in 2019, but cost margins fell to 52 bps from 53 bps from previous year, the result of a larger AUM denominator, mostly driven by market effect. Costs increased across the value chain, led by sales and marketing (Exhibit 2, page 4). Taking a longer view, aggregate absolute costs grew 1.9 times revenues.

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between 2007 and 2019 and 2.3 times revenues from 2015 to 2019, indicating that banks have achieved little in the way of cost savings. The industry is actually accelerating spending, even as revenue growth has slowed in the last five years.

This failure to control costs despite pressure on revenues, led 2019’s C/I ratios to reach 71 percent—1 percentage point higher than in 2018, and their highest level since 2012. Twenty-two percent of booking centers became economically unviable during 2019, reporting C/I ratios greater than 100 percent.

Private banks tried to find growth with relatively higher-margin lending products, which grew by 7 percent from 2018. Share of AUM held in funds increased to 30 percent from 29 percent in 2018, with an increasing trend toward internal asset management, and away from third-party funds, as banks try to control clients’ costs of ownership while maintaining their own fee margins. The share of AUM in discretionary mandates remained stable at 28 percent from the year earlier, and at 19 percent for advisory mandates; however they continued to outpace the market with 12 percent growth in 2019.

Despite favorable market conditions, relationship manager (RM) productivity remained stable. Loading per RM increased slightly to €225 million from €218 million in 2018. However, revenues per RM remained relatively unchanged at €1.65 million (versus €1.64 million in 2018, and a high of €1.70.

Exhibit 1
Europe’s private banking profit pools contracted in 2019.

Profit pool, Europe average; € billion

![Graph showing profit pool, revenue margin, cost margin, and AUM growth from 2015 to 2019.](chart)

Source: McKinsey Private Banking Survey
The AUM impact of rising markets, rather than new inflows, provided the greatest revenue increase. Assuming market performance had been flat, and AUM growth were limited to net inflows from 2009 through 2019, loading per RM would be about one quarter less, at €176 million, and revenue per RM about 20 percent lower, at €1.29 million (Exhibit 3, page 5).

In terms of business models, onshore banks continued to surpass offshore institutions in winning inflows with 2 percent in 2019 against 1 percent for offshore counterparts, primarily driven by cross referrals, with differences between booking centers and countries.

Size still matters in turning a profit: On nearly every financial parameter, booking centers with AUM less than €10 billion continue to lag booking centers with AUM over €30 billion. Smaller booking centers turned in C/I ratios averaging 99 percent, more than twice that of their larger peers. The lower cost ratios of private banking arms of onshore universal banks—with C/I ratios of 53 percent—makes them the most profitable, while independent onshore private banks continued to register the highest net flows and the highest revenue margins.

In terms of client segments, the ultra-high net worth segment (clients with AUM greater than €10 million) again enjoyed the fastest growth, rising to 50 percent of AUM versus 47 percent in 2018.

An overwhelming share of participants in our 2019 survey noted that their number-one priority was fostering organic growth in existing
markets. Prior to the emergence of the COVID-19 pandemic, their plans included digitizing the front office, increasing the proportion of mandate services and front-office effectiveness, as well as optimizing their value proposition and pricing. Cost reduction, sustainable investing, advanced analytics, and M&A remained low on the agenda. To control costs, the three main actions survey respondents noted are investing in process automation, reducing FTEs, and cutting spending on selling, general, and administrative expenses. These strategic priorities reflect an optimistic pre-pandemic sentiment that the private banking industry would continue to grow, in spite of the reality of 12 years of erosion in revenue margins and a decline in the profit pool for a second year running. Moreover, net inflows have been hard to come by, and banks have made only limited progress in controlling costs. The priorities also signal that the industry collectively believed that markets, client expectations, and operating models were sound, and did not require a fundamental rethink.

**COVID-19 will put many European private banks under prolonged stress**

In 2020, Europe’s private banks made a resilient start after a disappointing 2019, driven by increased trading activity as the crisis took hold. Although AUM fell by 10 percent as markets dropped, and deposit margins were reduced, banks’ profit pools increased by 7 percent to €14 billion (representing a margin of 23 bps) on an annualized basis. The aggregate revenue pool increased by 3 percent to

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**Exhibit 3**

**RM productivity increases largely driven by market performance rather than by net flows.**

**Load factors, Europe**

<table>
<thead>
<tr>
<th>Year</th>
<th>Indexed</th>
<th>Number of RMs</th>
<th>AUM/RM € million</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>100</td>
<td>140</td>
<td>140</td>
</tr>
<tr>
<td>2015</td>
<td>100</td>
<td>161</td>
<td>196</td>
</tr>
<tr>
<td>2018</td>
<td>100</td>
<td>171</td>
<td>218</td>
</tr>
<tr>
<td>2019</td>
<td>99</td>
<td>176</td>
<td>225</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>AUM/RM with only net inflows</th>
<th>AUM/RM with net inflows and performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>+61%</td>
<td>+28%</td>
</tr>
</tbody>
</table>

Source: McKinsey Private Banking Survey

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€47 billion (a margin of 76 bps), while the cost pool rose 2 percent to €33 billion (a margin of 53 bps) (Exhibit 4).

However, the surge in brokerage from COVID-19-driven trading activity masked the underlying trend of falling revenues. Share of brokerage revenues increased by 4 percentage points on an annualized basis from 2019 and provided a cushion to recurring investment mandate income, share of which fell by 2 percentage points, and banking income, share of which was down 1 percentage point. Moreover, the short-term brokerage-driven revenue boost was the result of clients shifting 3 percent of their total assets from equities into cash and equivalents at no or negative interest rates; this shift would create a substantial drag on investment mandate income in the coming quarters.

Looking to the global financial crisis as a guide, global GDP fell 1.7 percent in 2009, and private banking industry profits needed 10 years to recover (as revenue margins shrank by 23 bps from 2007) (Exhibit 5, next page). Under a range of COVID-19 macroeconomic scenarios develop by McKinsey in partnership with Oxford Economics, global GDP drops from between 3.5 percent to 9.7 percent for 2020. This points to a revenue and profit path that could be more damaging.

Assuming a 5 percent revenue contraction and 2 percent operating cost increase, our sensitivity analyses shows that an additional 9 percentage points of private banks’ booking centers will likely turn unviable in 2020, with C/I ratios greater than 100 percent—reaching one-third of the total (Exhibit 6, page 8).

The participants in our first-quarter 2020 survey indicated that their top three strategic actions in the coming three to six months will be: broadly assessing their product portfolios and technology investments; activating contingency cost reductions; and new product development. These are sensible steps toward resolving the immediate challenges of the COVID-19 crisis, and should support a gradual

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Exhibit 4

Profit pool increased in 1Q 2020, fueled by revenue uplift.

![Graph showing the profit pool increased in 1Q 2020, fueled by revenue uplift.](image)

- **Profit margin, bp**: 21 (2019) to 23 (Q1 2020)
- **Revenue margin, bp**: 73 (2019) to 76 (Q1 2020)
- **Cost margin, bp**: 52 (2019) to 53 (Q1 2020)
- **AUM growth, percent**: 10 (2019) to -10 (Q1 2020)
- **Net inflow, percent**: 2 (2019) to 0 (Q1 2020)
- **Performance impact, percent**: 8 (2019) to -10 (Q1 2020)

¹ Q1 2020 figures have been annualized for comparability.

Source: McKinsey Private Banking Survey
return to business. However, the shift in client and employee behaviors, coupled with secular pressures that already existed in the industry, necessitate a much needed fundamental transformation.

**Strategic priorities for emerging stronger after the crisis**

As private banking pre-COVID recedes in the rear-view mirror, the industry needs to shift gears to move from the crisis to the next normal, and from resolve and resilience, to begin the reimagining of a better future. The impact of COVID-19 has instigated or accelerated three trends that private banking leaders must confront.

First, interest rates will likely remain low for the foreseeable future, leaving limited revenue upside from interest margins. In addition, market uncertainty and volatility are likely to remain high, even taking into account the dramatic actions of central banks to support markets. Recurring fee income may become more volatile, as mandates have grown as a proportion of AUM. Moreover, choppy markets may send some investors into elevated cash positions, creating another drag on fees.

Second, clients’ preferences regarding sales and advice channels have shifted quickly—for reasons of health and safety—toward digitally enabled remote solutions. Today, 71 percent...
of clients prefer multichannel interaction, and 25 percent express a desire for a fully digitally enabled private banking journey with remote human assistance when needed. Our experience suggests that, across industries, the initial trial stage has been the single biggest hurdle for digital adoption. However, the crisis has required the majority of clients to experiment with digital channels, and it would be reasonable to expect heightened expectations of clients for digitally enabled private banking even after the crisis.

Delivery models aside, it is also important to point out that clients seem somewhat unsatisfied with the current state of the private banking industry, according to the 2020 McKinsey Affluent, Private and HNWI Customers’ Insights Survey. For example, about one quarter said their main private bank made no contact during the COVID-19 crisis. A third of clients report being unsatisfied with the quality of financial advice from their main bank, and at least one in five clients moved their assets to another bank, due to their banks’ performance during the COVID-19 crisis. This behavior is even more prevalent in affluent and lower HNW client segments.

Third, the share of employees willing to work remotely has doubled to 80 percent, according to McKinsey’s COVID-19 Smart Working Survey. Many private banking employees have been able to work from home most or all of the time during the COVID-19 restrictions—with some exceptions such as traders, who require specific on-site systems—aided by secure and remote working tools.

Thus, private banks face three new challenges: pressures on revenues and profits from the uncertainties brought about by the COVID-19 crisis, an acceleration in client demand for digital service, and a shift toward remote working.

### Exhibit 6

The percentage of unviable booking centers in Europe could reach one-third in 2020.

**Booking centers (BCs) in Europe by scale level**

<table>
<thead>
<tr>
<th>Scale (AUM € billion)</th>
<th>Profit margin, bps</th>
<th>Share of total AUM</th>
<th>Share of unviable BCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>30+</td>
<td>39</td>
<td>69%</td>
<td>13%</td>
</tr>
<tr>
<td>15 - 30</td>
<td>22</td>
<td>22%</td>
<td>13%</td>
</tr>
<tr>
<td>5 - 15</td>
<td>10</td>
<td>7%</td>
<td>32%</td>
</tr>
<tr>
<td>&lt; 5</td>
<td>1</td>
<td>2%</td>
<td>44%</td>
</tr>
</tbody>
</table>

Share of total AUM: 100%  
Share of unviable BCs: 22%  
**(9 pps)**

1. Total booking centers: 102.  
2. Unviable defined as zero profit margin.  
3. Sensitivity analysis assuming a ~5% revenue contraction and ~2% operating cost increase.  
Source: McKinsey Private Banking Survey 2020
To meet these challenges, European private banks must rapidly reimagine client coverage, and deliver a remarkable client experience powered by technology; reconfigure the operating model; and inject a social purpose into their business choices. Even though some of these strategic priorities are not new, and some private banks have made progress on them, the urgency has been heightened as a result of the crisis (Exhibit 7).

**Deliver remarkable client experience powered by technology**

*Deliver next-generation multichannel client experience:* Firms outside banking have already been raising the bar on client expectations, with remarkable client-centric moments at every stage of the journey, delivered seamlessly across channels. The pandemic has further exposed the limitations of private banks’ omnichannel capabilities. As client demand for digitally enabled remote interactions from their banks grows, banks must urgently rethink their client service model and proposition. Banks need to start from the client perspective, and work backwards to see how experience could be provided remotely through secure omnimunication channels—such as videoconferences, webinars, and secured chat—and invest in cybersecurity to ensure these channels are safe to use. Private banks will need to offer seamless mobile touchpoints with anytime-anywhere access.

Despite what seems to be a clear call for digitally enabled service delivery, only one third of our survey participants place digitization of the front office and client interaction as a top priority. Banks will only be able to make the required investment in building the digital channels if they also increase RM productivity and lower front-office costs (more on that later).

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**Exhibit 7**

**Strategic priorities for Europe’s private banks.**

1. **Deliver remarkable client experience powered by technology**
   - Deliver next-generation multichannel client experience
   - Reimagine advice and relationship management through technology
   - Accelerate the pace of innovation

2. **Reconfigure the operating model**
   - Redesign the coverage model
   - Zero-base the central functions
   - Embrace agile ways of working and strive for greater workforce flexibility

3. **Inject purpose into business choices**
   - Deeply reflect on bank’s vision
   - Adopt a holistic approach to creating value for clients
   - Inject purpose into offerings
Reimagine advice and relationship management through technology: The success of social media and retail platforms has demonstrated the power of personalised and curated content. Private banks should take a cue from this success to personalize the content and advice experience delivered across channels, and not just during the periodic RM delivered advice process, as has been the traditional approach. Such personalized content can range from investment advice to holistic wealth planning and beyond, including lifestyle experiences (e.g., health advice, or virtual private gallery tours). The coverage model will need to evolve such that RM teams are more tightly aligned to client segments based on behaviors and demographics (e.g., women, millennials) to deliver those personalized experiences. At the same time, digital experience could be supplemented by do-it-yourself tools including wealth calculators and goal-based tracking of performance, to deliver personalized, analytics-driven, 360-degree views to clients. However, few private banks mention advanced analytics among their top strategic priorities. Now may be the time to reconsider.

The newly designed advice experience should be supported by a revamped value proposition that takes a total-wealth perspective for creating value for clients and includes access to products likely to increase in importance (e.g., alternatives, private investments, ESG). (See next page for more on ESG.)

Accelerate the pace of innovation: While the bar for delivering remarkable experience is rising, private banks have traditionally been slow to innovate and transform client journeys. However, the crisis has highlighted the potential to substantially increase the metabolic rate of innovation by adopting ways of working. For example, banks can increase the pace of innovation through a series of targeted service enhancements delivered via a minimum viable product approach with faster deployment time and the opportunity to co-create with clients. Some financial institutions have managed to deploy new digital journeys and MVPs at breakneck speed through the crisis—a sharp contrast to pre-crisis timelines. Banks should maintain the same urgency and rigor in their transformation plans.

When designing next-generation journeys, it is essential to embrace the needs and reactions of different client segments, and design each journey from a zero base and end-to-end perspective; that is, not simply digitizing existing processes, or offering isolated use cases.

Reconfigure the operating model

Redesign the coverage model: Private banks should consider substantially evolving their front-office coverage model given the growing prevalence of remote client engagement and greater client preference for omnichannel, digitally supported interactions. First, banks should consider relocating RMs to fewer centers to drive scalability and shift to flatter team structures. Second, digitally enabling the RMs can also go a long way in enhancing productivity. Enhanced RM tool-kits (e.g., end-to-end RM workbenches for client prospecting and client service management) and remote client engagement tools (e.g., secured video conferencing, screen sharing) are important building blocks of digitally enabling the front office. Third, RM performance measurement and incentives will also need to evolve to reflect the new coverage model and reduced demand for RM time aided by digitization of the front office.

These steps will enable banks to improve organic growth and reduce reliance on unsustainable RM hiring-driven growth. When acquiring talent, banks should also consider diversifying the profile of RMs to address client segments with evolving needs (e.g., entrepreneurs, millennials).

Zero-base the central functions: Banks need to make their central functions more efficient by managing demand, redesigning end-to-end processes, and launching rapid automation at scale. Banks should also radically redesign those core functions that must be kept in house, while reviewing potential candidates for outsourcing.
and capturing the scale benefits of industry utilities, or leveraging group-level resources such as custody and securities operations. Such zero-basing of central costs is no longer a "nice to have" but an existential requirement given the economic pressures on the industry.

**Embrace agile ways of working and strive for greater workforce flexibility:** Implementing agile ways of working will help client needs become even more central to a bank’s efforts and give them the nimbleness they need to succeed in a rapidly changing world. Agility helps reduce time to market and raises productivity, while promoting an empowered culture to increase employee engagement and facilitate faster decision making. And yet, only one third of our survey participants consider organizational agility a top priority. The COVID-19 crisis has led some banks to start embracing agile ways of working; going forward, the choice for many banks will be whether to return to old ways of working, or to fully embrace client-centricity and agility.

Private banks will also need to develop greater flexibility in their workforce to be resilient through the uncertain times that lie ahead. Banks need to assess their talent pool, combine tasks by skill and level of specialization where feasible, and systematically redeploy talent against changing demand. In addition, banks should launch reskilling and capability building at scale, to create the flexible and talented workforce of the future. Greater flexibility in workforce deployment can also be an important part of increasing overall productivity.

**Inject purpose into business choices**

**Deeply reflect on bank’s vision:** As stewards of wealth, banks need to deliberate on their long-term purpose and vision with the next generations in mind—those clients and prospects who place importance on making a social impact. Management should set a high bar for values and behaviors, and embed them in a revised brand message. Clients are likely to rate institutions that demonstrate social responsiveness significantly higher than those that do not, especially during the COVID-19 crisis and after.

**Adopt a holistic approach to creating value for clients:** To create value for clients, a “total wealth” perspective is essential—with distinctive wealth structuring, cash-flow planning, and life-cycle planning services supported by a suite of suitable products (investments, lending, and insurance). Delivering such a holistic offering, without asking clients to undergo the hassle of sharing extensive data during fact-finding, will require orchestrating or participating in ecosystems through acquisitions or partnerships (or in the case of universal banks, alignment with retail divisions). As managements assess additions to their offerings, they should also critically evaluate where they can create value for clients, and eliminate offerings that do not make the grade.

**Inject purpose into the offerings:** Banks should consider embedding sustainability and ESG propositions into all product offerings, to underline their long-term vision for their clients and society and meet the needs of emerging client segments (e.g., millennials). Yet, only 16 percent of our survey participants consider sustainability a priority driven by client demand, a desire to create positive impact on society, or regulation. These banks aim to put sustainability into action, by embedding it in the investment process or by minimizing the bank’s ecological footprint. In addition, banks can develop value-generating products suitable in the new macroeconomic environment that rigorously protect and grow capital (through inflation/deflation scenarios, capital protection, and alternative asset classes) while strengthening risk management (against pandemic risks, for example).

**Accelerating transformation to thrive in the new normal**

What should guide banks’ strategic priorities as they work to keep pace with a changing world? First, managements should acknowledge the need to accelerate their transformation if they want to thrive, or even survive, in the post-pandemic landscape. To meet potential disruptions and
Challenges to profitability, banks will need to set clear and ambitious aspirations for their future in the new normal and substantially increase the pace of execution. Banks will also need to reset their cost base to underwrite future investments in new capabilities, invest to maximize productivity gains, and spur revenue growth. In parallel, building a culture of continuous improvement is critical given the pace of change we anticipate in the private banking industry in the coming years. They will also need to stay flexible, given the unknowns surrounding the development of the current crisis.

Private banks in Europe can emerge stronger from the COVID-19 crisis by leveraging the enduring trust-based relationships they have built by successfully safeguarding wealth for generations, through other crises and across centuries. But they will only do so if they act with urgency, bearing in mind Harry Truman’s advice: “Imperfect action is better than perfect inaction.”
Methodology

McKinsey’s annual Private Banking Survey, launched in 2002, provides comprehensive insights on the private banking industry. The survey is a global effort comprising most relevant markets: Western Europe, Central and Eastern Europe, Asia, and North America. For Western Europe, 102 banks participated in the 2019 survey this year.

The participating banks in Western Europe cover a range of sizes and business models. Thirty three percent of total participants were private-banking units of universal onshore banks, 29 percent were offshore private banks, 23 percent independent boutiques, and 15 percent private banking units of foreign firms.

Firms apply varying methods to allocate revenues and costs within their wealth management operations, and among their wealth management activities and parent companies. These differences have been reconciled as far as possible, but some variations may remain, which could distort the final results.

McKinsey thanks all participants for their valuable contributions to the 2019 and 2020 Q1 surveys, which have enabled a better understanding of the economics of wealth management.