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Unsettled times in European private banking

The industry continued to recover in 2010, but many challenges remain.

Europe's private-banking industry continued to recover in 2010, helped by a bounce in financial markets. But looking ahead, they remain volatile, profitability and net inflows are still well below the levels achieved before the crisis, offshore markets remain under pressure from regulators, and the full impact of new regulation has yet to be felt.

These are among the main conclusions of the recent McKinsey & Company report *2011 McKinsey Private Banking Survey: First signs of renewal*. Executives at more than 160 banks from 26 countries provided 2010 data and insights for the analysis.

On average, European private banks increased their assets under management last year by 9 percent. Net inflows, however, amounted to only 2 percent, low by historic standards: they averaged 7 to 8 percent between 2005 and 2007. The remaining 7 percent increase in assets under management in 2010 was attributable to market appreciation—a level unlikely to be maintained in 2011, given the performance of financial markets so far this year.

Profit margins rose by 4 basis points in 2010, up from 20 basis points in 2009 to 24 basis points, still 11 basis points below the high of 2005 to 2007. Revenue margins also remained low by historic standards—83 basis points compared with 84 basis points in 2009 and 100 basis points at the peak of the cycle, in 2005. Banks attribute reduced revenue margins to declining customer deposits, reduced trading activity (hence lower brokerage fees), and greater risk aversion. On a brighter note, cost-containment efforts appear to be bearing fruit: in 2010 the industry had average cost margins of 59 basis points, down from the equivalent of 64 basis points of assets under management in both 2008 and 2009.

In the wake of heightened international concern about tax evasion, the survey shows that there were no overall net inflows to private banks in European offshore locations. Switzerland's asset base remained stable in 2010 thanks to emerging markets, some of which provided double-digit net inflows. Luxembourg, significantly more dependent on European customers, managed to offset its rapidly declining share of affluent clients by attracting ultra-high-net-worth investors seeking structured investment products.

The performance of individual private banks still varies widely: those that fared best were boutiques and universal banks in their home markets onshore and independent boutiques offshore. Overall, some 10 percent of the private banks in our sample experienced losses, and 32 percent suffered net outflows.

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One of the industry's major challenges—in addition to dealing with volatile capital markets—will be increased regulation, notably demands for greater transparency and possible pressure on commissions. This development will create additional downward pressure on margins.

Download the full report on the McKinsey & Company Web site.