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THE WALL STREET JOURNAL.

Morgan Stanley Wealth Division Is Probed

By AnnaMaria Andriotis
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Multiple federal regulators are probing Morgan Stanley over how it vets clients who are at risk of laundering money through the bank's sprawling wealth-management division.

The Securities and Exchange Commission, the Office of the Comptroller of the Currency and other Treasury Department offices are involved, according to people familiar with the matter. That is in addition to the Federal Reserve, whose similar probe The Wall Street Journal reported in November. The Fed has told the bank that supervisory action is under consideration.

The main issues regulators are looking at boil down to whether Morgan Stanley has been sufficiently investigating the identities of prospective clients and where their wealth comes from, as well as how it monitors its clients' financial activity. Some of the probes are focused on the bank's international clients.

The bank has been working on addressing the issues regulators have raised. When asked about some of the regulatory scrutiny in January, Morgan Stanley's former chief executive and current executive chairman, James Gorman, told the Journal the bank is investing in compliance, **technology** and artificial intelligence to better understand the flow of money tied to its wealth business.

Morgan Stanley shares fell sharply after the Journal reported on the wider probe and closed down more than 5%.

The SEC last year sent Morgan Stanley a list of current and former clients with questions about how they were vetted. It also questioned why Morgan Stanley's financial-adviser unit, which works directly with affluent individuals, did business with some clients who were cut off by E*Trade, the Morgan Stanley-owned digital-trading platform, because of red flags.

The SEC's list includes a billionaire with ties to Russia who has been sanctioned by the U.K. and an individual who said she was based in the U.S. but whose activity on E*Trade indicated she was located on a Caribbean island and had more money in her account than would be typical for someone with her stated occupation.

The Treasury's Financial Crimes Enforcement Network, known as FinCEN, also sent the bank a list of client names, at least some overlapping with the SEC's. Morgan Stanley also received an administrative subpoena from the Treasury's Office of Foreign Assets Control requesting information on the firm's sanctions policies and procedures, according to a bank document viewed by the Journal.

The OCC late last year sent Morgan Stanley what is known as a matter requiring attention over customer due diligence. That followed an annual exam of the bank's **anti**-**money**-**laundering** and related programs, according to some of the people and a Morgan Stanley document that says the firm sent detailed action plans to the regulator.

Morgan Stanley's wealth unit has been critical to the firm's strategy since the 2008-09 financial crisis. The bank made several acquisitions, including those of Smith Barney and, more recently, E*Trade, that turned it into a wealth-management juggernaut overseeing a total of about $5 trillion. The division, which accounts for about half of the company's total revenue, generates steady revenue streams Morgan Stanley relies on to help smooth out downturns in investment banking and trading.

The wealth division has been showing signs of slowing down, with revenue flat in the fourth quarter from a year earlier. Net new assets totaled $47.5 billion in the period, down 8% from a year earlier after a 45% decline in the third quarter.

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THE WALL STREET JOURNAL.

Heard on the Street
Wealth Management Is Risky for Banks --- Catering to the rich offers high returns and room for growth, but it isn't for every big lender

By Jon Sindreu
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[Financial Analysis and Commentary]

Today's markets love nothing more than a growth narrative and with wealth management, banks finally have one. The risk is that they all crowd in at the same time.

Among banks valued above $100 billion, Morgan Stanley and UBS have been the top stock-market performers of the past half-decade. Both companies bet on wealth management and private banking. Morgan Stanley, now the highest-valued big bank in the world, acquired asset manager Eaton Vance and online broker E*Trade with a goal of managing $10 trillion in client assets. UBS incorporated Credit Suisse, creating a wealth-focused behemoth under the "Swiss banking" brand.

Understandably, others are trying to follow in their wake. Goldman Sachs, the emblematic Wall Street trading house, has merged and reshuffled its asset- and wealth-management divisions in a push to make them generate a much bigger chunk of the group's earnings. France's BNP Paribas is planning "massive growth" in Switzerland to scoop up some of Credit Suisse's former business, according to an interview with the boss of its Swiss wealth division in trade publication Citywire.

Britain's HSBC and Lloyds also are moving in this direction. Even Barclays, which in February ruled out a full pivot away from investment banking, aims to strengthen its small Private Bank & Wealth Management arm. Deutsche Bank has hired more relationship and investment managers in Germany even as it has retreated from investment banking.

The industry's love affair with the rich is a rational one. Post-2008 regulations require banks to hold more capital, which is a bigger problem for investment banking than for relatively capital-light wealth management. Among top banks in the U.S. and Europe, wealth- and asset-management arms had an average return on tangible equity of 21% in 2023, compared with a paltry 12% for investment banking.

Also, the trading gains made by investment banks, which depend on the gyrations of financial markets, are an unreliable source of income. Even stripping out the 2008 crash and the pandemic, since 2004 they have been four times as volatile as fees and commissions. Moreover, transaction-based fees made up only 15% of wealth-management revenue in 2023, according to Coalition Greenwich. Rich clients, who are usually locked in for years, pay much more in recurring fees, hold large amounts of cash and, crucially, take out loans. This means a lot of stable net interest income, which amounted to almost half of revenue.

To boot, wealth management is poised for growth. The UBS Global Wealth Report anticipates that there will be 86 million millionaires in the world by 2027, up from 59 million in 2022. It is a market served by local relationships, which means the top banks have only a 32% share, Coalition Greenwich research shows. That leaves room for growth. In trading and corporate finance, where economies of scale are strong, top banks' share rises to 67% and 48%, respectively.

Digital **technology**, artificial intelligence and greater access to private markets seem likely to make large wealth platforms increasingly attractive to clients as well, especially for the "mass affluent" who have between $250,000 and $1 million in investible assets.

This cohort currently makes up less than one-quarter of the wealth revenue of the top players. Providing automated customized recommendations to them as a kind of "Netflix of banking" was one of UBS's pitches before the Credit Suisse acquisition.

But there are risks as banks all pile into the theme. High-net-worth individuals -- those with more than $1 million -- might be able to drive a harder bargain in a more-crowded market. Below that line, low-cost robo-advising **technology** is already squeezing profit margins.

The surge in wealth-management assets in recent years also has been matched by increasing expenses. Cost-to-income ratios average 77%, compared with 68% for investment banking and 56% for other banking lines. The U.S., where financial advisers play a more prominent role, is a particularly high-cost market.

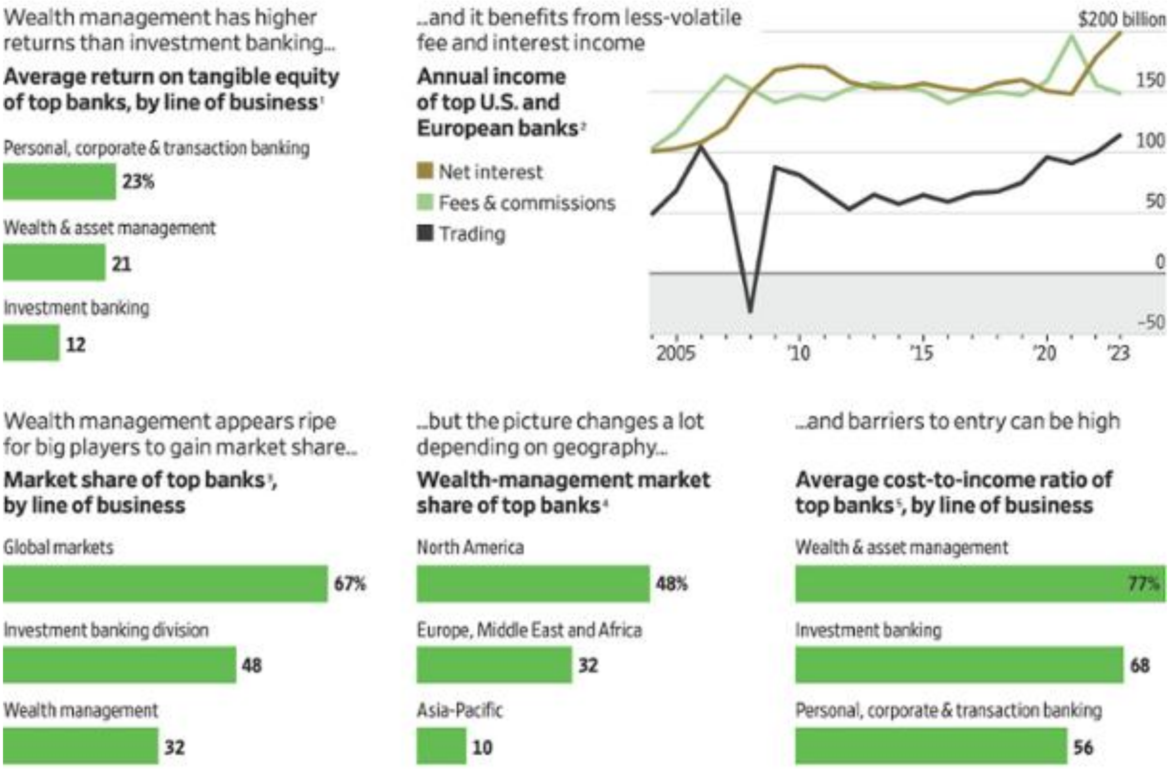
Today's wealth management is both relationship-based and reliant on hefty **technology** investments. This means firms find it much easier to grow through acquisitions, which can cost a lot. In 2022, for example, UBS agreed to -- and then backed out of -- a deal to buy California-based digital platform Wealthfront at a steep valuation, in an attempt to reach out to affluent millennials and Gen Zers. Executives have since shifted their attention to the ultrawealthy and are now trying to penetrate the U.S. by wooing family offices.

The room to grow varies greatly depending on geography. In North America, top banks hold half the market. In Asia-Pacific, it is only 10%.

UBS last week laid out plans to boost its presence in Asia, which makes sense given that it dominates the market. It is the same for HSBC, which last year bought Citi's retail wealth-management portfolio in China. Similarly, Deutsche Bank's focus on rich clients in its domestic market seems wise.

But lenders should be wary of venturing into high-cost areas where they don't have a strong foothold, whether geographically or in terms of the clients targeted. This is why Goldman's ambitious wealth-management foray under Marc Nachmann, who comes from a markets and investment-banking background, seems risky -- even if it is going well so far.

The bank's recent retreat from consumer banking came with a broader lesson: Not everybody can do everything.



[1]Includes Goldman Sachs (Asset & Wealth Management plus Global Banking & Markets only), Morgan Stanley, JPMorgan, UBS (2022 underlying results) and Deutsche Bank
[2]At current exchange rates. Includes Goldman Sachs, Morgan Stanley, JPMorgan, UBS, Credit Suisse, Barclays, HSBC, BNP and Deutsche Bank [3]2023 data for 12 selected banks
[4]2023 data for 10 selected banks [5]Latest data from Goldman Sachs (Asset & Wealth Management plus Global Banking & Markets only), Morgan Stanley, JPMorgan, UBS (2022 results), BNP and Deutsche Bank

Sources: the companies (average return, annual income, avg. cost-to-income ratio); Coalition Greenwich (market share of top banks, wealth-management market share)

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