OLIVER WYMAN

THE BRAZILIAN INVESTMENT LANDSCAPE
A new era for Brazilian investors

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EXECUTIVE SUMMARY

Brazilians have traditionally invested conservatively in basic savings accounts and fixed income products, but that is changing as Brazil undergoes a series of demographic and macroeconomic transformations that encourage diversification. As interest rates and inflation drop to unprecedented levels and the number of middle-class households grows, retail investors have started searching for higher yields and make more medium-term investment plans.

On the institutional side, high government indebtedness has led to a decrease in government expenditures and investments as well as a lower participation of state-owned banks in the economy. Consequently, the crowding-out effect on private investments has weakened. This renewed need and political support for private funding coupled with low interest rates is stimulating corporates to tap capital markets, matching investors' needs for diversification and higher yield.

The combination of search for diversification and higher yields on the demand side and need for alternative sources of funding from the supply side is triggering a change on the structure of the Brazilian investment landscape, impacting the investment market in Brazil:

- Investors are likely to diversify into a broader set of asset management products, shifting away from risk-averse savings products into more attractive investment vehicles; the total share of saving accounts (Poupança) and cash investments has dropped from 25 percent in 2012 to 20 percent in 2018 and we expect this trend to continue in the next coming years.
- Investors are likely to seek tools and advice in navigating a more complex financial planning landscape as product choice and diversity multiplies.

This drive for product diversification within a more complex product offering is driving a growing demand for comparison platforms, risk management tools and advisors that can offer customized and individualized investment guidance. In parallel, the expansion of digital solutions is providing greater access to products and information that were once restricted to subsets of banks' clients.

The trend to channel diversification is set to accelerate as challenger institutions, with nimbler business models that leverage truly native digital analytics capabilities, are quicker to provide investors with customized solutions that better meet their needs. In a survey with investors, over 70 percent of respondents are satisfied with the product range offered by independent platforms, whereas only 35 percent are satisfied with banks' product range.

While banks have an established trust relationship with a large base of clients, they have to deal with complex legacy systems, processes and organizations that are expensive to maintain. Challenger institutions, on the other hand, have a lower client base and brand recognition, but are light, quick and have greater capacity to provide niche offerings and greater tailoring to broader base of clients.

In Brazil, we estimate that independent platforms hold nearly 10 percent of clients' assets and that this share could grow up to 25 percent in 2024. As investment platforms expands, they will have the possibility to tap into adjacent markets – such as payments, insurance, and credit-, tapping into the deep knowledge they are constructing of their clients, a nascent trust relationship and leveraging their light and quick structure to provide more tailored solutions than currently offered by traditional institutions.

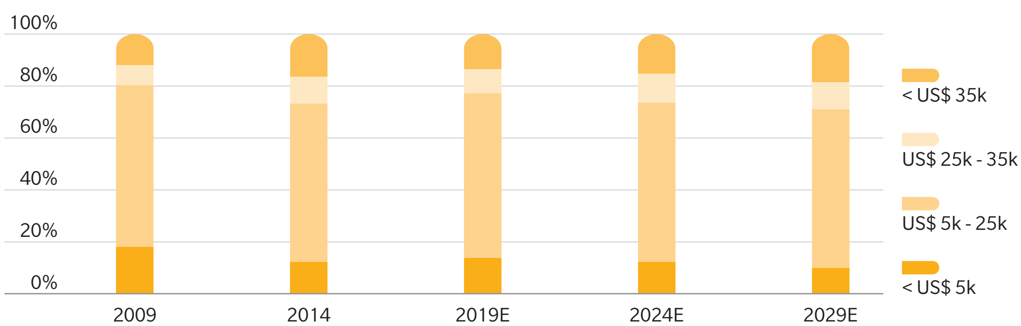
1. INVESTMENT FUNDAMENTALS:

DEMOGRAPHICAL AND MACROECONOMIC TAILWINDS

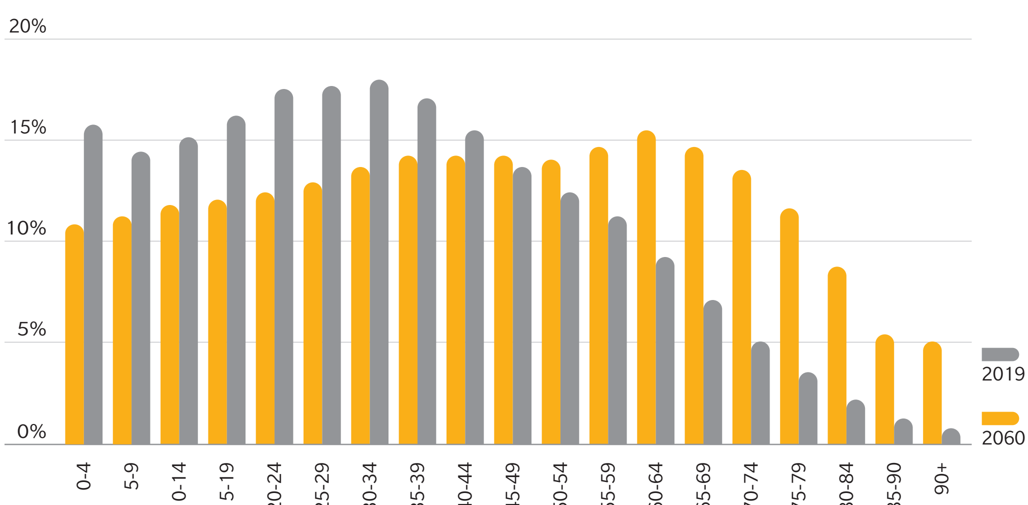
Brazil has a large and growing population, with ~220 million inhabitants it is currently the sixth most populous country in the world. Furthermore, like most emerging economies, Brazil has a population that is becoming older and with a larger share in the higher income brackets. The share of households earning more than US$ 25 thousand per year is expected to jump from 19 percent in 2009 to 26 percent by the end of 2024, while the number of inhabitants over 50 years old is expected to jump from 51 million today to 101 million by 2060 (see Exhibit 1).

Exhibit 1: Brazilian investment market demographics

EVOLUTION OF YEARLY HOUSEHOLD INCOME BY INCOME RANGE



BRAZILIAN POPULATION AGE DISTRIBUTION



Source: IBGE, Euromonitor — Passport.

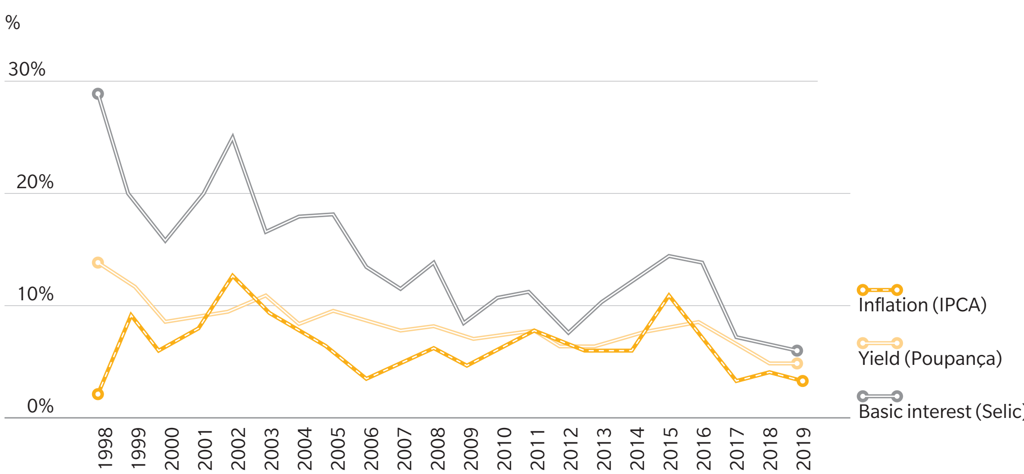
These are promising demographic fundamentals for the Brazilian investment landscape as more people save more in preparation for their old age. This will be supported by a growing investment culture that is quickly helping to increase the penetration of investment products. Despite having nearly 162 million bank accounts and 60 million saving accounts, there are still only 2.4 million investment accounts, including 1.2 million registered investors with the exchange, B3. That's just over two percent of the economically active population.[1]

Brazilians have been traditionally characterized by a risk-averse savings and investment behavior, investing mostly in fixed income products, particularly the Poupança savings account.[2] This behavior stems from the experience many current investors had throughout the eighties and nineties where these accounts where one of the few safe investment products. However, Poupança has offered very low returns in the recent past, at times even below the inflation (see Exhibit 2).

The Brazilian economy has transitioned from a high inflation and volatile interest rate into a more stable environment in terms of monetary policy. Nominal interest rates are at a historically low at 5.5 percent after peaking at 15 percent in 2015 and 25 percent in 2001.[3] Macroeconomists are considering the lower interest rate (both nominal and real) as the new normal for Brazil. Given this new scenario, Brazilian investors have started searching for alternative to the traditional fixed income products to capture a higher yield for their savings.

Indeed, in our survey with investors, 61 percent have said that they would not consider investing in poupança at all. Going forward, 66 percent answered they would be willing to invest in equities and equity derivatives in the future and 52 percent answered they would invest in funds. Only three percent mentioned Poupança as a future investment.[4]

Exhibit 2: Evolution of base interest rate and Poupança yield



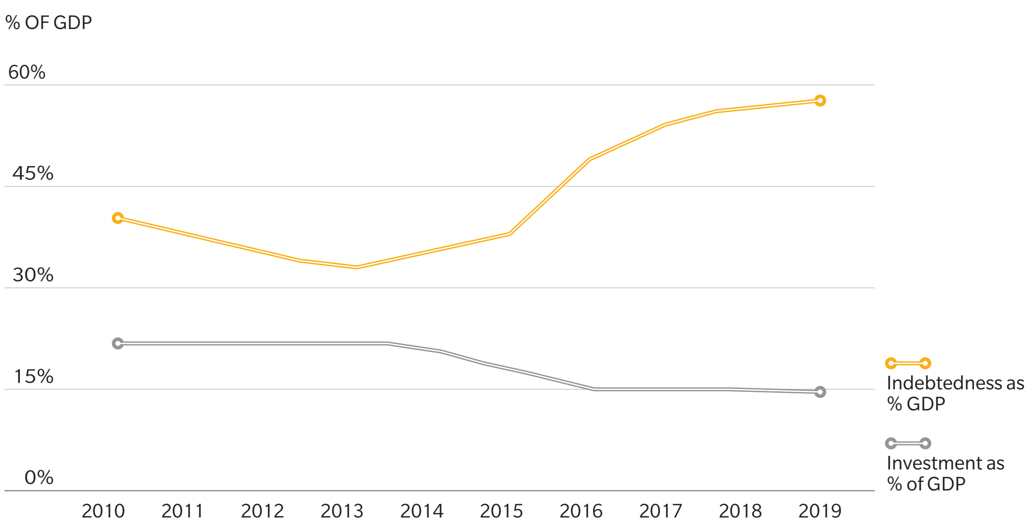
1. Includes the number of fiscal codes (CPFs) registered with each custody agent and number of active accounts at the Tesouro Direto. Data from B3 as of July 2019. Source: ANBIMA, B3, Brazilian National Treasury, IBGE.
2. Poupança is a traditional system of saving accounts that exists in Brazil for over 150 years. It pays 0.5% per month (or 6.2% per year tax free) plus a small correction for inflation if the base rate, the SELIC rate, is above 8.5% per year or 70% of the base rate if it falls below 8.5%.
3. SELIC as of October 2019.
4. Source: Survey Oliver Wyman InfoMoney from August 2019.

In addition to changes on the demand side, changes in the macroeconomic environment are also affecting the supply of financial products. In the past years the overall indebtedness of the public sector in Brazil has increased and reached 55 percent of GDP in June 2019 (from 30 percent of GDP in December 2013) (see Exhibit 3). This trend is expected to continue in the next coming years under a scenario with no changes to fiscal and budget policies.[5]

As a result, government expenditures and investments have been adjusted downwards. Specifically, the role of the public banks has decreased and as a consequence the crowding-out of private investments. This renewed need and political support for private funding coupled with low interest rates is stimulating corporates to tap capital markets, matching investors' needs for diversification and higher yield.

The combination of search for diversification and higher yields on the demand side and need for alternative sources of funding from the supply side is triggering a change on the structure of the Brazilian investment landscape.

Exhibit 3: Evolution of Brazilian net public debt and total investment



1. Net debt of the public sector and total investment in Brazil.
Source: IPEA.

5. Source: IFI.

2. THE NEW INVESTMENT ERA

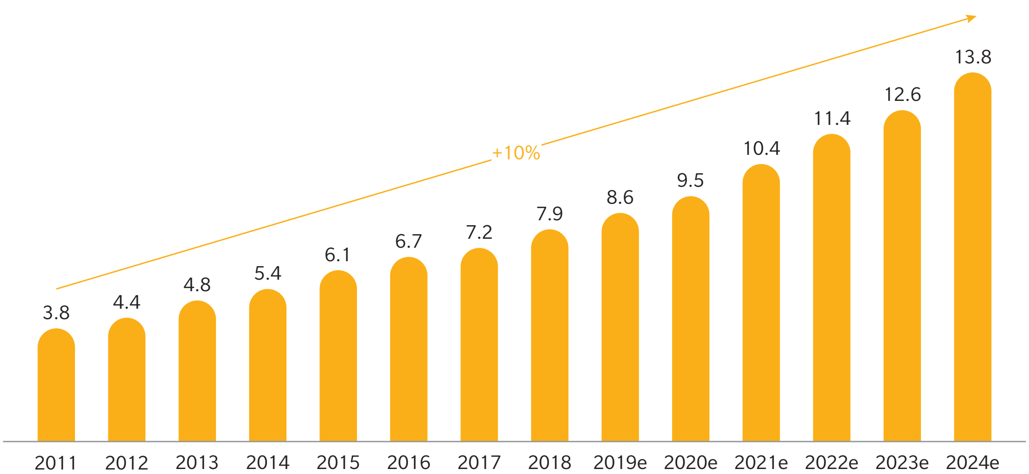
PRODUCT DIVERSIFICATION AND SOPHISTICATED FINANCIAL PLANNING

The effects described in Section one have caused Brazilian investment assets to boom over the past few years. From 2011 to 2018, total investments grew from R$ 3.8 trillion to R$ 7.9 trillion, an 11 percent CAGR (see Exhibit 4).

This evolution is even more impressive when analyzed against the backdrop of a severe economic crisis of 2014-2016. Unemployment rate has increased from four percent in December 2013 to 12 percent in May 2019, whereas real GDP per capita has shrunk by eight percent between 2013 and 2018 and nominal GDP has grown six percent per year on average.[6] Still, investment assets grew 11 percent in nominal terms on average per year from 2011 to 2018. As the economy has started to recover and the middle class expands, we expect growth to continue over the coming years.

Exhibit 4: Evolution of volume of investment assets

R$ TRILLION, NOMINAL VALUES

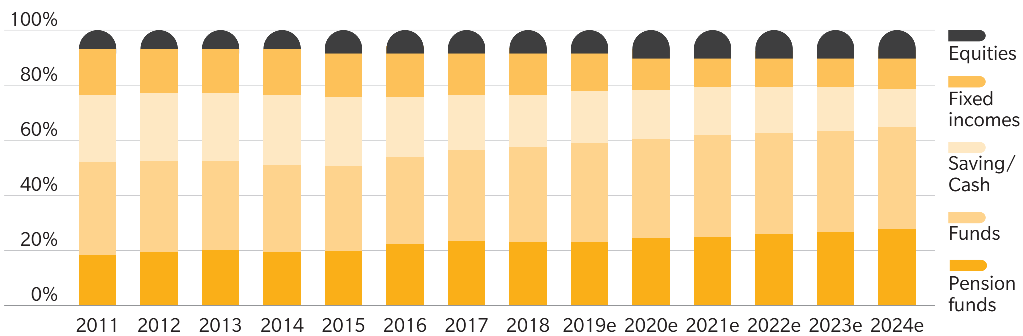


Note: Includes investment assets from retail (inc. pension funds and offshore) and corporate (non-financial and insurance).
Source: Brazilian Central Bank, ANBIMA, EIU, ABRAPP, SUSEP, Itaú. Oliver Wyman analysis.

6. Source: IBGE.

Higher-yielding products such as equities or structured products are expected to grow even faster than the overall market as well as the pension segment. As investors expect the low interest rate environment to stay, the shift from fixed income to higher-yielding assets is already becoming evident. Between 2015 and 2018 the share of fixed income securities of total investments has dropped from 22 percent to 19 percent and the share of Poupança and cash investments has dropped from 25 percent to 20 percent (see Exhibit 5). In addition, the pension segment has grown 14.5 percent per year on average between 2011 and 2018, and the expectation is for this segment to keep growing above the market going forward. Even so, Brazil remains one of the most conservative investment environments by international comparison with one of the lowest equity allocations (11 percent) (see Exhibit 6). As an additional example, there are R$ 115 billion from high net worth and ultra-high net worth individuals allocated in Poupança accounts.[7]

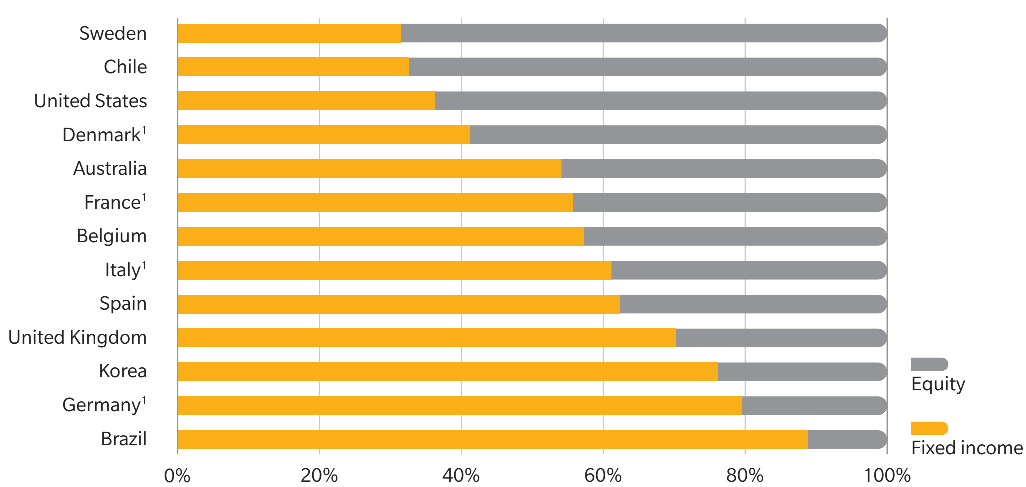
Exhibit 5: Evolution of investment assets by product type



Source: Brazilian Central Bank, Anbima, EIU, ABRAPP, SUSEP, Itaú. Oliver Wyman analysis.

Exhibit 6: Evolution of investment asset mix – international comparison

% OF TOTAL FINANCIAL ASSETS



1. Data from 2017. Fixed income includes currency and deposits and securities other than equity; excludes mutual funds, pension plan and life insurance.
Source: OECD, Anbima.

7. Data as of 2018. Source: ANBIMA.

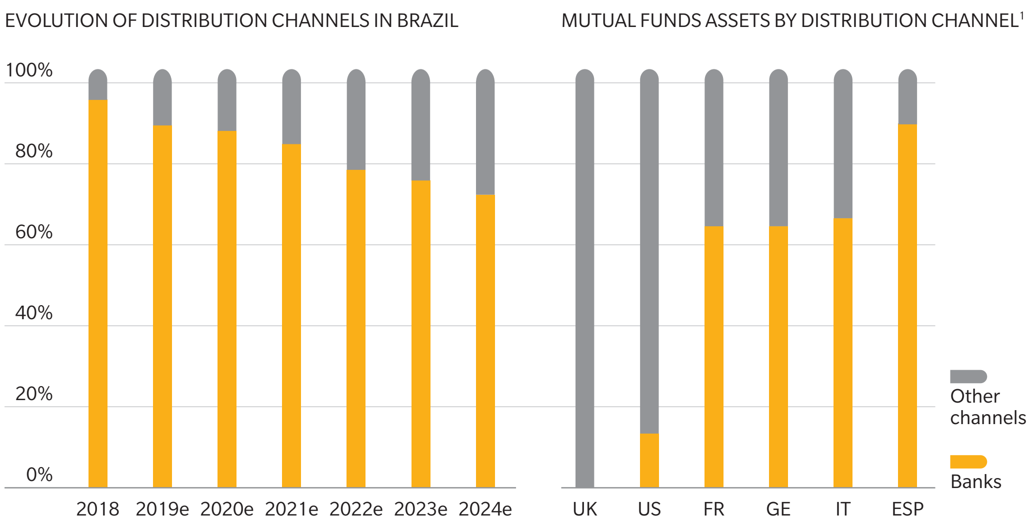
With the rising complexity of new investment products, the expansion of the number of investors and the growing number of investment choices, investors will need sophisticated intermediaries and advice to find the products that best suit their investment needs.

This change drives a growing demand for comparison platforms, risk management tools and advisors that can offer customized and individualized investment guidance. In many markets independent advisors have been the most effective channel to navigate a broad offering and support their clients with tailored solutions.

While banks in Brazil still account for over 90 percent of Assets under Custody (AuC), brokers and independent advisors are consistently gaining market share (see Exhibit 7). Between 2016 and 2018 their share has grown from five percent to seven percent and is expected to continue to grow in the coming years as investors continue to look for independent advice, breadth of products and open architecture.

While some Brazilian banks have opened their product suite to independent manufacturers, the offering has historically fallen short of changing demand. When compared to international markets, Brazilian investment distribution is still dominated by banks, while many of the international markets have made a transition to other distribution channels.

Exhibit 7: Evolution of distribution channels



1. For banks, it includes both retail and private banking branches as well as online banking; it excludes networks of IFA belonging to the groups. 2017 data.
Source: ANBIMA, Valor, Infomoney survey May/2017, Financial Times, Platforum. Oliver Wyman analysis.

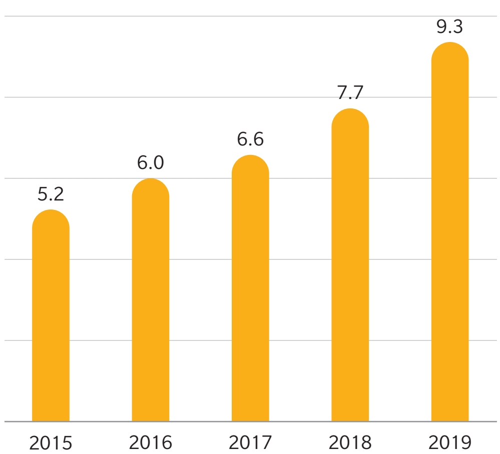
The increasing relevance and demand for independent investment platforms is being supported by a large and growing pool of independent advisors. Since 2015, the number of registered independent advisors (Agentes Autônomos de Investimento) in Brazil has increased from just over 5,000 to over 9,000. In the United States, there were 12,578 registered investment advisors (RIAs) in 2018 within a universe of over 300,000 people that work with financial advisory and planning.[8]

Independent advisors fulfil a key role in advising on more complex and long-term investments: 17 percent of investors in our survey have answered that they prefer to invest with an advisor than to make the decision by themselves. As the industry evolves and products become more complex, the demand for advice is set to increase. We expect that, similarly to what happened in other countries, independent advisors will become multi-product advisors and include other long-term products such as insurance and mortgages over time.

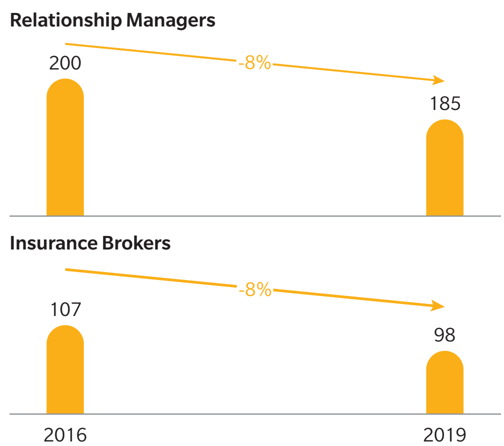
As banks continue to close branches to move to a more digital presence, we expect bank managers with previous expertise and strong client bases to become independent financial advisors helping brokers and independent platforms to continue to earn market share. For example, between January 2016 and June 2019, Itaú, Bradesco and Santander – the top three private banks – have closed 11 percent of their branches (or 1,349 branches).[9] The same analogy holds for insurance brokers; since 2016, there was an eight percent decrease in the number of registered insurance brokers in Brazil (see Exhibit 8).

Exhibit 8: Number of independent financial advisors, branch managers and insurance brokers

EVOLUTION OF REGISTEREED
BRAZILIAN IFAs
2015-2019 (IN THOUSANDS)



EVOLUTION OF BRANCH MANAGERS AND
INSURANCE BROKERS[2]
2016-2019 (IN THOUSANDS)



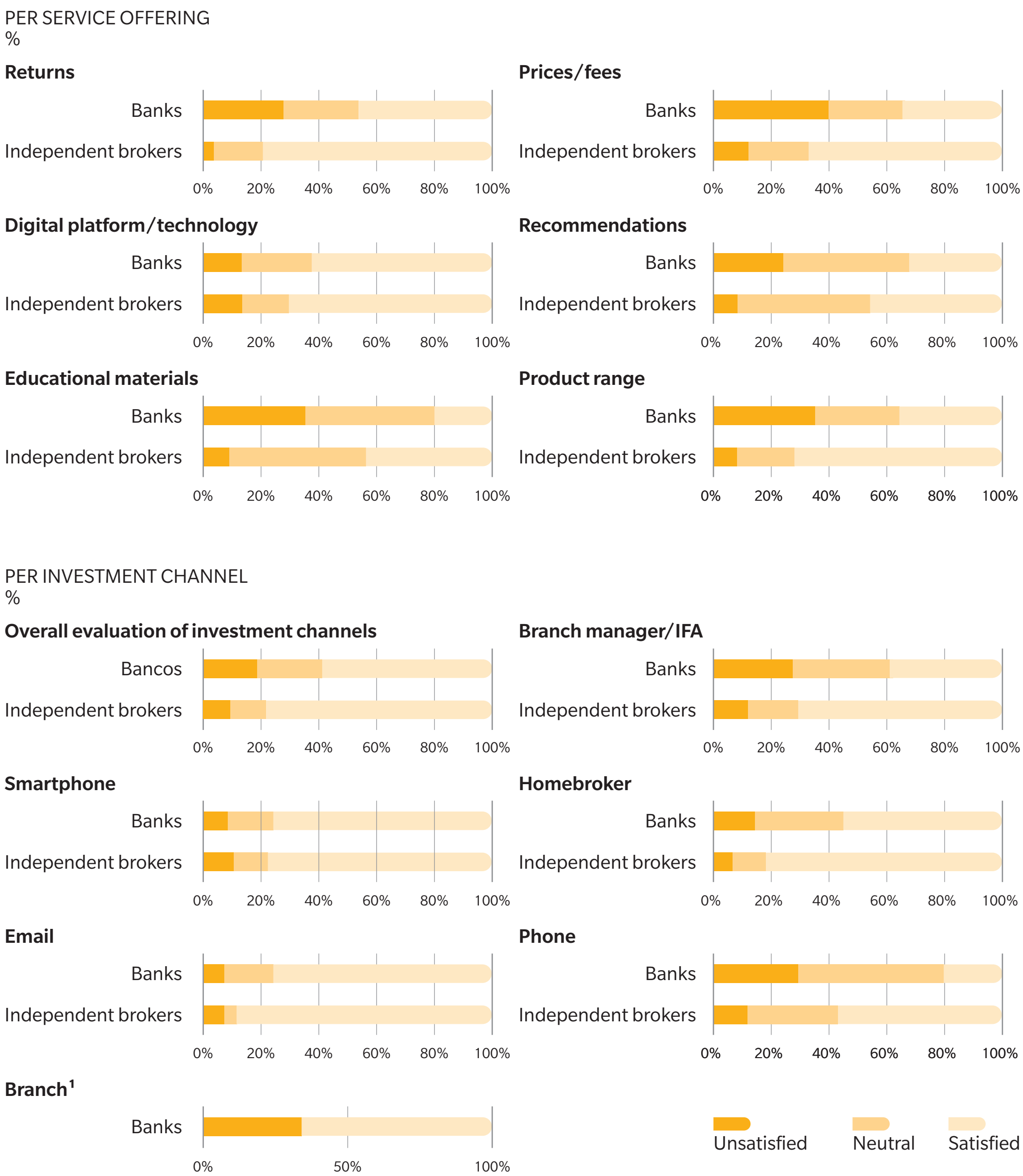
Source: Ancord, Brazilian Central Bank, CVM, SUSEP, Oliver Wyman analysis.

8. Source: SEC for Registered Investment Advisors and Cerulli Associates for financial advisors in the United States.
9. Includes HSBC retail branches that have been acquired by Bradesco. Source: Brazilian Central Bank.

This channel diversification trend is set to even accelerate as challenger institutions, with nimbler business models that leverage truly native digital analytics capabilities, are quicker to provide investors with individual or mass customized solutions that better meet their needs. Indeed, our survey shows that 89 percent of respondents who are considering investing in the future would rather do it through an independent financial broker, while only 11 percent would choose a bank.

As for investment channels, our survey demonstrates that apart from smartphones – investors' favorite channel – independent brokers are better rated than banks for all other categories (see Exhibit 9).

Exhibit 9: Investors evaluation of investment channels and service offerings



The same pattern holds true when investors evaluate the service offering. The survey participants were much less satisfied with their bank's returns, prices and product range than they were with what they got through the brokers. This is most likely explained by the fact that independent brokers are open architecture and offer a much broader choice of products and investment options. Digital platforms and technology are however rated with similarly high satisfaction for banks and brokers, which indicates that independent brokers will need to better combine independent advisors with their digital offerings (see Exhibit 10).

Although investors are migrating to independent platform, banks still fare well on platform stability and trust, but have been unable to adapt their offer spectrum to fulfil more tailored needs. When investors are asked why they would migrate to other institutions, better returns and a greater variety of products were mentioned as the main reason (see Exhibit 11).

The customer service and experience gap of unmet needs and offers has opened a gap that nimbler, technology-based companies have begun to explore, filling a space left by the traditional banks. With their product and sales-oriented approaches, banks have been slow to truly adapt to a customer centric approach that is able to meet clients' true individual needs.

Exhibit 10: Channel usage for investments

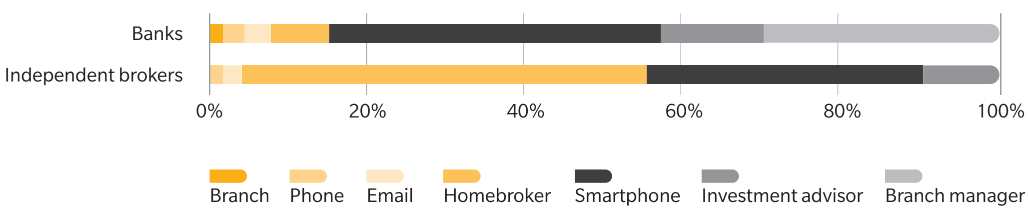
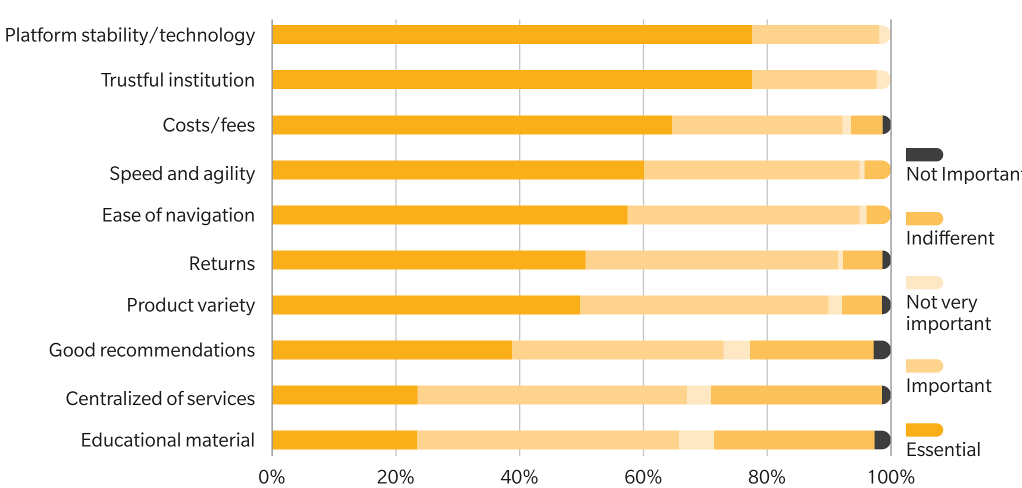


Exhibit 11: What do you consider important in your investment platform?

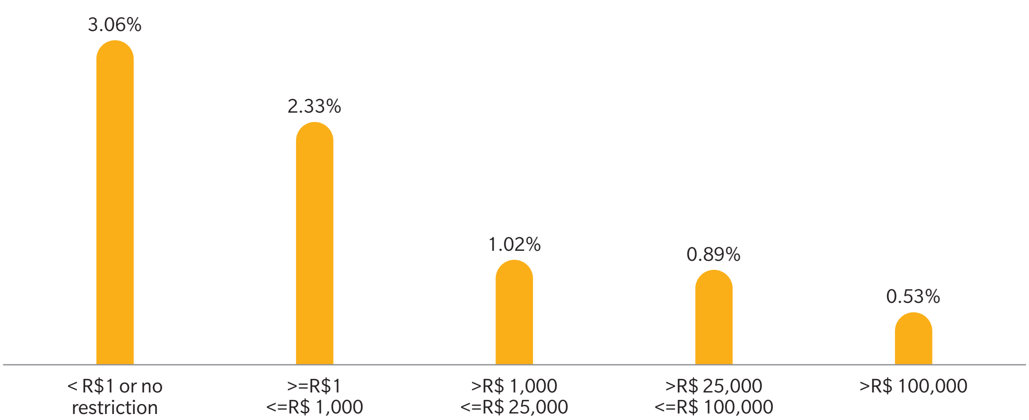
% OF TOTAL ANSWERS



Despite the acknowledged importance of customer centricity, it has proven difficult for product organizations to think of the customer outside of the context of their products or for horizontal innovation teams to drive customer outcomes across the competing demands of different product lines and outside the bank product scope. Most financial institutions are still grappling with product and functional silos, where product manufacturing and distribution are two distinct components of their operating models. In addition, legacy IT systems and the installed infrastructure of branches are difficult to overcome and require significant investment to restructure.

As a result, banks are not fully addressing customers' needs. For example, in many institutions, mass market segments have been de-prioritized, leaving a large chunk of the market underserved or subject to high fees. Comparing administration fees for fixed income funds, for example, funds that require a minimum investment of less than R$ 1,000 are charging an average fee of 2.33 percent whereas the average for all fixed income funds is 1.01 percent (see Exhibit 12).

Exhibit 12: Average administration fee for fixed income funds per minimum level of investment



Note: Fees as of June 2019.
Source: ANBIMA.

Exhibit 13: Comparison of competitive advantage banks vs. challenger institutions

	TRADITIONAL BANKS	INDEPENDENT BROKERS/ CHALLENGER INSTITUTIONS
Technology	Legacy systems that are expensive to maintain and update In-flight process redesign requiring greater time and effort to launch	Nimbler platforms that are cheaper to maintain and update Starting from new, shorter time to launch
Costs	Higher customer to FTE ratio Expensive physical branch structure, hard to cut due to multiservice offer and union pressure Requires large network of branch managers and in-house investment advisors	Lower cost base Small physical presence, with mostly digital/ remote offering Supported by a large network of independent advisors
Trust	High brand recognition Reliability and established trust relationship	Limited brand recognition Limited track record to establish degree of reliability
Attractiveness	Multi-service offering, large cross-sell opportunity Large client base Limited tailoring below UHNW individuals Deprioritization of mass clients	Limited offer of products and services in one place, limited opportunity of cross-sell Small client base Niche offering, opportunity for greater tailoring Value proposition for mass clients

3. THE NEXT FRONTIER

MULTI-PRODUCT FINTECHS AND CROSS-SELLING

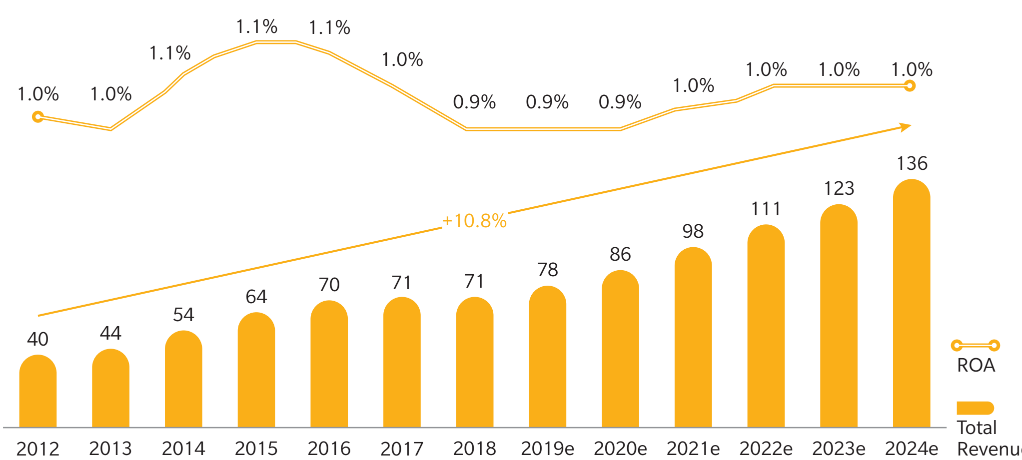
With R$ 7.9 trillion in assets in 2018, the investment market is large on its own. A bottom-up analysis of average fees charged by incumbents indicates an average ROA of one percent that would translate into a revenue pool of ~R$ 71 billion.[10] As assets are expected to continue to grow at ~11 percent per year until 2024, the investment market alone should be a R$ 136 billion opportunity in the next five years (see Exhibit 14).

This large market is currently underserved by traditional banks and challenger institutions have understood the potential for disruption. In the recent years, there has been significant innovation and investment in the Brazilian investment services industry. For example, the number of investment-focused fintech's grew from four firms in 2015 to 29 in June 2019.[11]

In investment, nimbler organizations, highly leveraging technology have been able to address market segments traditionally underserved by banks. With a lower cost base that leverages robo advice and advanced algorithms, investment-focused fintechs have started to provide customized services to customers on the mass segment, enabling a "mass" personalization of investment processes and services. Although robo-advice has not replaced human input, it has been proving to be a crucial tool to provide scale to the financial advisor.

Exhibit 14: Total investments revenues and RoA

IN R$ BILLIONS AND PERCENTAGES



Source: Brazilian Central Bank, ABECS, The Economist Intelligence Unit, SUSEP, Oliver Wyman analysis.

10. Return on assets – RoA – has been calculated as the ratio between total revenue from administrative fees and total volume of assets under management (average between current and previous year) for retail investments, non-financial corporates and investments from insurance companies.
11. Source: FintechLab.

This new service model has already brought significant change in the market. As an example, Charles Schwab, the US-based broker, has announced on October 2019 the decision to reduce online trade commissions for U.S and Canadian-listed equities and ETFs to $0, and to reduce the base charge on options to $0, as well.[12] This has come as a response to the change in the competitive environment, with new entrants using zero or low commission as a lever to enter the market. The business model of the future monetizes data and services rather than direct compensation for (decreasing) execution costs.

When looking at challenger institutions, we have observed five successful entry strategies across international markets. Players start from a clear problem for a specific group of people and, as the solution is developed and gain momentum, other solutions are added providing a better and more complete experience for the customer (see Exhibit 15).

Exhibit 15: Value propositions of challenger institutions in the investment services industry

VALUE PROPOSITION	DESCRIPTION AND CORE TARGET AUDIENCE	FUNCTIONALITY
"Your financial co-pilot"	• Offers in-depth advice in investment and financial products – has sophisticated real-life experience sharing and examples – e.g., calculating the cost of a year out. • Millennials/digital economy workers/lifestyle	• Calculators and simulators • Robo advisory • Purpose-based portfolio • Borrow/portfolio line of credit
Regular savings and spend wisely	• Offers simple funding of investment through rounding up credit card spent (only small amount needed) – found money and debit card • Millennials/thrifty savers/ bargain hunters	• Automated portfolio investment • Found money (ad referral earnings – e.g., Uber bookings) • Debit card and analytics
Beginners – we teach you investing	• Offers broad information and investment education as well as low cost/level investment and "practice" portfolios. Offers to plan spending and investment • Millennials/young families	• Kids custodial account • Automated portfolio investment • Credit, debit and bill pay • Spend, advice and planning • 2-day payday cash advance for free
We help you to care for your employees (SME)	• Offers SME employers to provide retirement plans and benefits to their employees • SMEs with less than 90 employees	• Portfolio selection • Automated portfolio selection • Employer plan management
We help you invest and manage your banking needs	• Offers full banking services to individuals – online and in-person advice – different service offerings at different price-points depending on needs • All investors	• Full banking product suite (investments, credit and payments/cash management) • Calculators • Robo advisory

12. Charles Schwab announcement on October 1st 2019.

What these strategies have in common is the construction of successful cross-selling propositions. Based on the harvesting of relevant data, successful challengers have been able to better serve and continuously adapt to their customers' needs. While in the past the lack of client data limited the ability to add value and deepen the client relationship, organizations in the investment industry today can build a full view of clients across their lives span and identify emerging needs. This allows for a much richer engagement and differentiated value proposition.

For players in the investment industry, there is an increased ability to expand to adjacent markets. Managing investments requires a higher level of trust from clients as the payoff will only come in the future, whereas for cards or loans, for example, the client gets the benefit in the short term. Hence, it is easier for players in the investment segment to expand into other areas than the other way around. Indeed, many disruptors in the investment market of developed countries have evolved to include in their offering adjacent products such as (i) insurance brokerage, (ii) credit and debit cards and (iii) consumer loans.

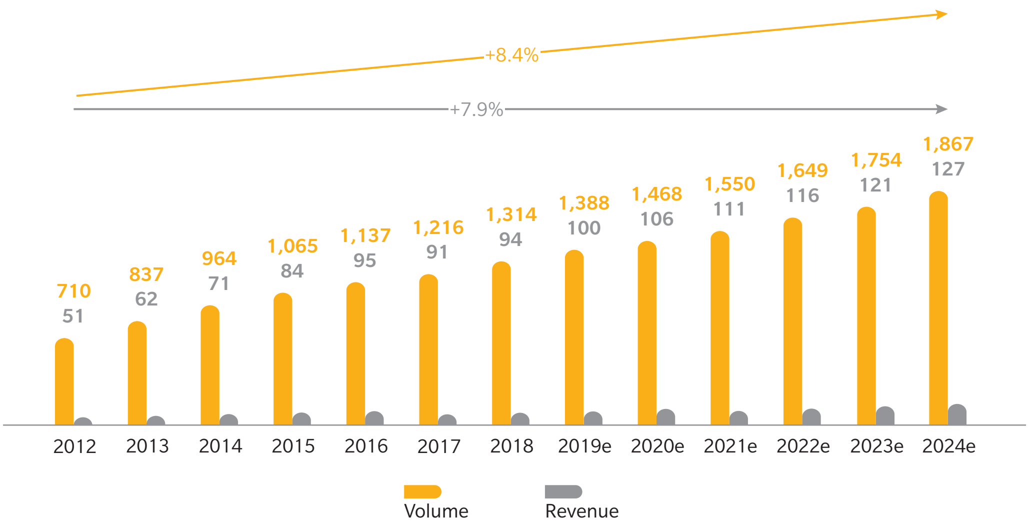
In the United States, Robinhood was launched in 2014 as a commission-free trading app. Although it provided a limited offering compared to other brokers, Robinhood has been very successfully acquiring customers, particularly among a younger demographic, and the app has amassed millions of users. At the same time Robinhood also expanded the product range into banking products such as cash management services.[13]

In Brazil, these adjacent offerings mean a significant expansion of total addressable market for brokers and independent investment platforms. For cards, the volume of electronic payments using debit or credit has grown from R$ 710 billion in 2012 to R$ 1.3 trillion in 2018. With R$ 76 billion in outstanding balances with average interest rates varying from 159 percent to 313 percent the debit/credit card market alone would mean a revenue pool of R$ 94 billion (see Exhibit 16).[14]

13. Source: Bloomberg, https://www.bloomberg.com/news/features/2018-02-08/brokerage-app-robinhood-thinks-bitcoin-belongs-in-your-retirement-plan.
14. Includes revenues from overdraft (debit card), loans outstanding (revolving credit and *parcelado*), MDR, POS rental, cards fees, and receivables.

Exhibit 16: Credit and debit cards volume and overall revenues

R$ BILLION

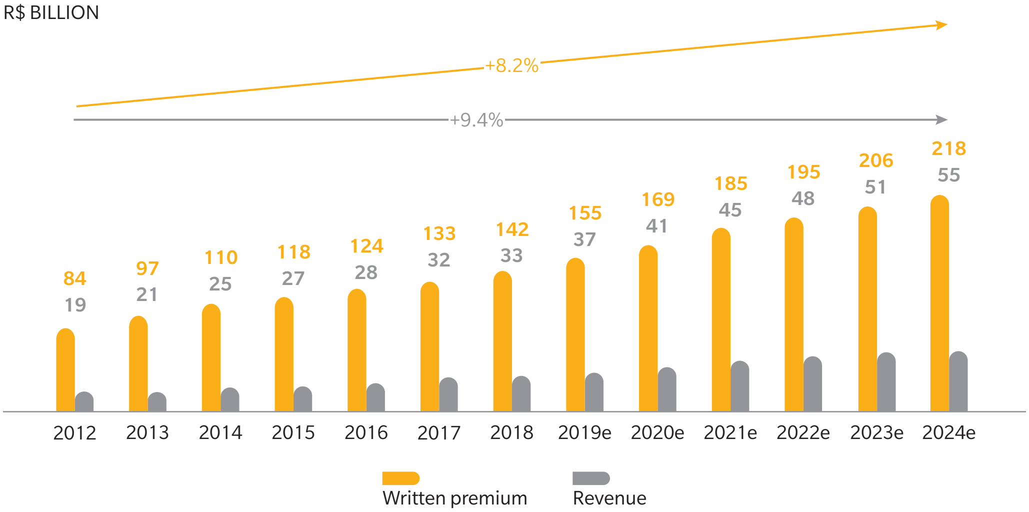


Note: includes revenues from loan on balances, MDR, receivables, card fees, and POS rental. In 2017, a one-month cap has been imposed on revolving credit; after this period, consumers have to be offered another type of line of credit.
Source: ABECS, Brazilian Central Bank, Oliver Wyman analysis.

The insurance market, with a written premium of R$ 142 billion in 2018, has grown ~68% since 2012, which reflects a 11 percent CAGR and a R$ 33 billion revenue opportunity for brokers (see Exhibit 17).[15]

Exhibit 17: Insurance premium and brokerage revenues

R$ BILLION



Source: SUSEP, Oliver Wyman analysis.

15. Revenues reflect brokerage fees.

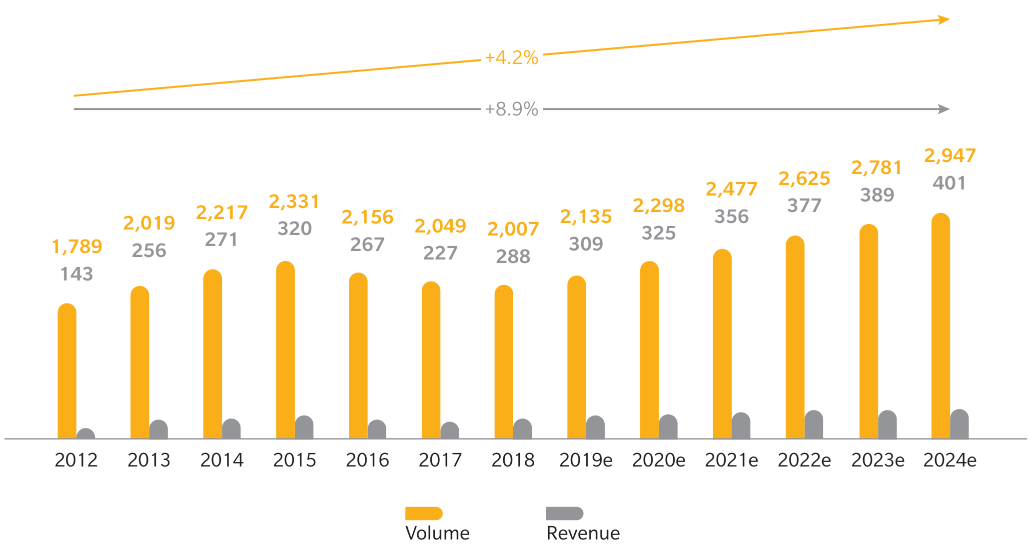
Lastly, there were R$ 2.0 trillion in outstanding loans in the end of 2018 with average interest rates varying from 10 percent for mortgages to 107 percent for personal loans. These loans constitute another R$ 288 billion revenue pool (see Exhibit 18).[16]

Of course, not all this revenue pool will necessarily be tapped by investment players, however opportunities abound. To illustrate a few, with a significant volume of assets under management, margin loans can be an interesting product. Even if they represent the equivalent of one percent of retail customer AUM that would mean an extra R$ 69 billion in loans.

As challenger institutions become established in their segments and data availability increases, the probability of expanding and developing successful cross-sell propositions also grows. Indeed, given the market concentration and the underserved consumer needs, fintechs will compete on who will be able access these different markets.

Exhibit 18: Consumer and corporate loans

R$ BILLION



Note: Includes corporate loands and consumer loans (personal, payroll, auto and mortgage loans).
Source: Brazilian Central Bank, Oliver Wyman analysis.

16. Includes car loans, personal loans, overdraft, mortgages, and payroll loans (Consignado).

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting. With offices in 60 cities across 29 countries, Oliver Wyman combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation. The firm has more than 5,000 professionals around the world who work with clients to optimize their business, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is a wholly owned subsidiary of Marsh & McLennan Companies [NYSE: MMC].
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