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What’s new and what’s not in US wealth management

Global Wealth & Asset Management December 2018

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At the height of the global financial crisis in 2008, the S&P ended the year at 903. Today, nearly ten years later, it is trending toward 3,000. In 2008, Apple sold about 10 million iPhones. Today, annual sales exceed 215 million. Over the same 10-year period, the value of a New York City taxi medallion doubled, from $650,000 to $1.3 million, and then plummeted to below $250,000. With these developments in mind, we thought it would be appropriate to reflect on what has changed in the US wealth management industry over the past decade, and what remains the same:

What's the same?	What's different?
1. The industry sits at an all-time high, given its performance is highly correlated with capital market appreciation and interest rates	1. When adjusted for external tailwinds, industry profits have decreased—a strong indicator that wealth management firms are not well positioned for growth in a different macroeconomic environment
2. The industry is among the most profitable and competitive in the financial services ecosystem	2. The face of competition is changing, with "platform" tech companies entering financial services
3. Banking products are part of the holistic set of solutions offered by many wealth managers	3. Banking is now a major profitability driver and strategic source of client acquisition for wealth managers
4. Open architecture and distribution remain at the core of wealth managers' operating models	4. Asset management partners are evolving into partner/competitors, with some developing and expanding direct-to-consumer distribution models
5. Clients value advisor relationships and personalized advice	5. Technology-enabled remote and digital advice is becoming increasingly efficient, cost-effective, and well-received by consumers (e.g., the digital advice segment grew by more than 90 percent in 2017)
6. Wealth managers are putting client needs first	6. Client needs—and clients themselves—are changing; today's underserved segments will account for 50 percent of tomorrow's clients
7. Wealth managers are investing heavily in technology to meet rising client expectations	7. Client experience has emerged as a source of competitive advantage due to client expectations rising at an unprecedented pace, eclipsing the speed at which wealth managers are upgrading their offerings
8. Strong middle and back offices support clients and advisors	8. Technological tools and approaches are unlocking step changes in efficiency, reducing support function headcount by as much as 40 percent

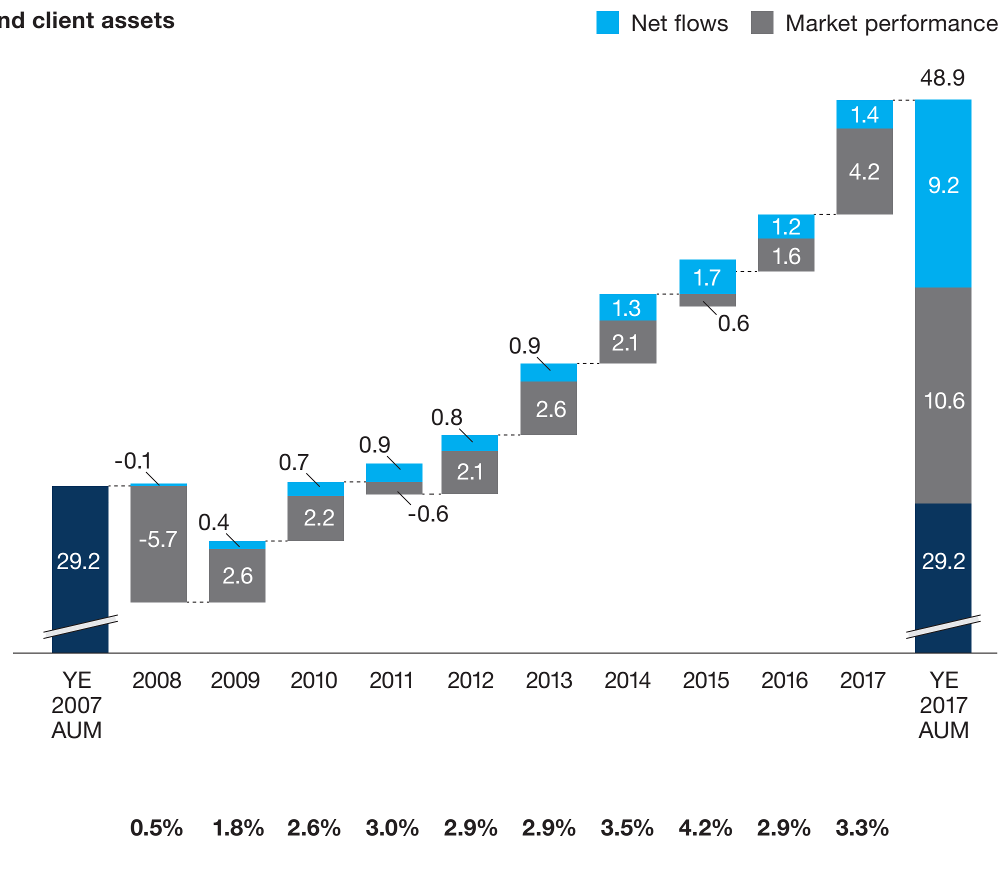
These shifts raise a number of questions for wealth managers. As in any industry in flux, the factors that fueled success to date are unlikely to be sufficient in the future. The confluence of ever-rising client expectations, step changes in technology, and the emergence of new business models are not only changing what it takes to win but reshaping the playing field altogether. Armed with a robust understanding of what is changing and what remains the same, wealth management leaders should ask themselves fundamental questions about current performance, and consider what bold moves they can make today to succeed and compete through the cycle and into the future.

1. Can wealth managers maintain industry performance without strong market tailwinds?

Globally, 2017 was a banner year for the wealth management industry, thanks in large part to the market. While client assets hit a record $49 trillion (Exhibit 1), 75 percent of the growth

Exhibit 1

Global wealth management assets are at an all-time high.



[1] Includes 41 countries from North America, Western Europe, CEE, GCC, Developed and Emerging Asia, Latin America, and Africa.
[2] Numbers have been rounded off.
Source: 2018 McKinsey North America Wealth Management Survey; McKinsey Global Private Banking Survey

($4.2 trillion) was driven by market appreciation and the remainder by net flows. Growth was notably broad-based across just about every major geographic region, with Asia maintaining its position as the fastest-growing region, enjoying a remarkable 22 percent annual growth in client assets (Exhibit 2).

As client assets grew, industry economics reached new heights–global pre-tax operating profits grew by 0.6 to 24.4 percent, cementing the industry's position as one of the most profitable financial services segments. At the same time, overall profit pools grew by 14 to 29 percent across regions (Exhibit 3, next page).

Performance in the US was similarly strong, with profit pools growing by 15 percent, or $6 billion, driven by market appreciation, rising interest rates, and the continued migration of client assets to fee-based accounts (Exhibit 4, next page).

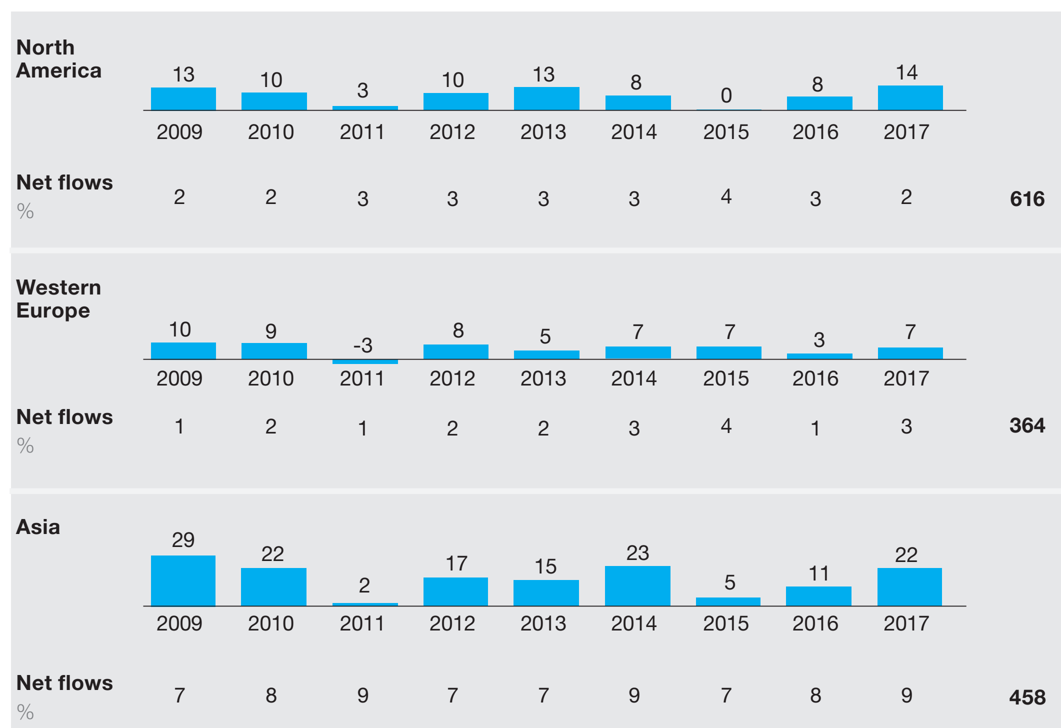
Setting aside the impact of favorable market conditions, however, reveals a bleaker picture in which the "organic" growth rate of profit pools is negative, and the year-over-year performance of many firms is declining (Exhibit 5, page 5). Moreover, the uplift provided by healthy growth in fee-based assets (e.g., 7 percent net flows among full-service brokerages) was somewhat

Exhibit 2

Asset growth has been broad-based geographically.

Growth in wealth management client assets
%

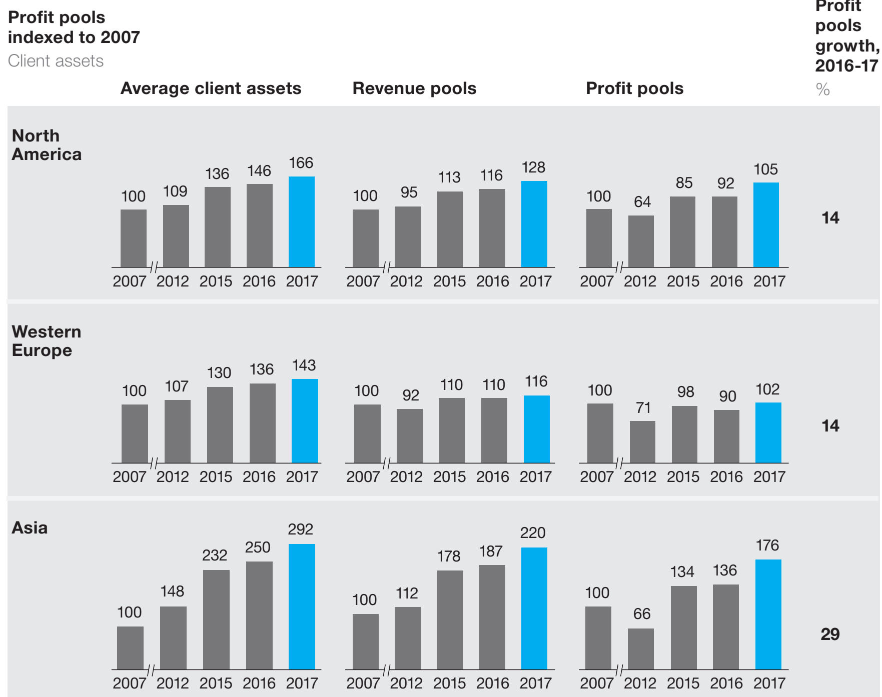
2017 net flows
$ billion



Source: 2018 McKinsey North America Wealth Management Survey; McKinsey Global Private Banking Survey

Exhibit 3

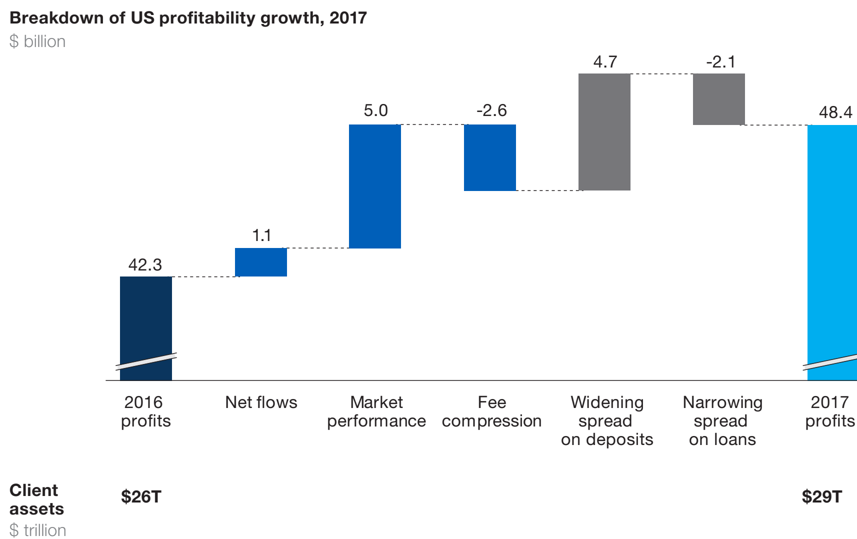
Global wealth management industry economics have been strong.



Source: 2018 McKinsey North America Wealth Management Survey; McKinsey Global Private Banking Survey

Exhibit 4

Growth in US wealth management profit pools was driven by strong market returns and widening spreads on deposits.

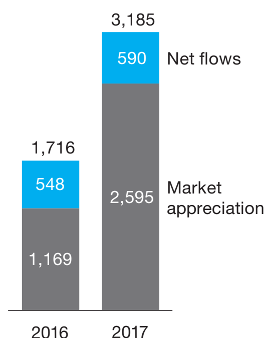


Source: 2018 McKinsey North America Wealth Management Survey

Exhibit 5

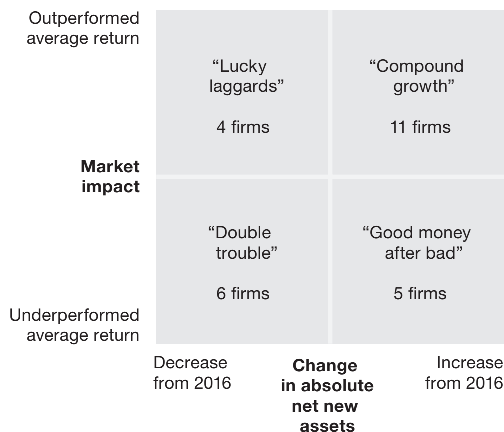
Favorable market conditions disguised relatively weak performance of some firms.

Contributors to asset growth, 2016-17
$ billion



Client assets $ trillion — **$26T** (2016), **$29T** (2017)

~40% of firms captured a smaller absolute amount of net flows in 2017 than they did in 2016 2016-17



Source: 2018 McKinsey North America Wealth Management Survey

muted by accelerating fee compression: according to McKinsey PriceMetrix, average pricing on fee-based accounts dropped by 5 bps in 2017, a sharper decline than the 3 bps drop observed in 2016.

2. What are the best ways to capture growth before platform players disrupt the industry?

Irrespective of whether and for how long market tailwinds persist, US wealth managers need to adapt their business models to reflect the changing industry landscape. The winners will be those who succeed in improving organic growth, which will require a new set of capabilities.

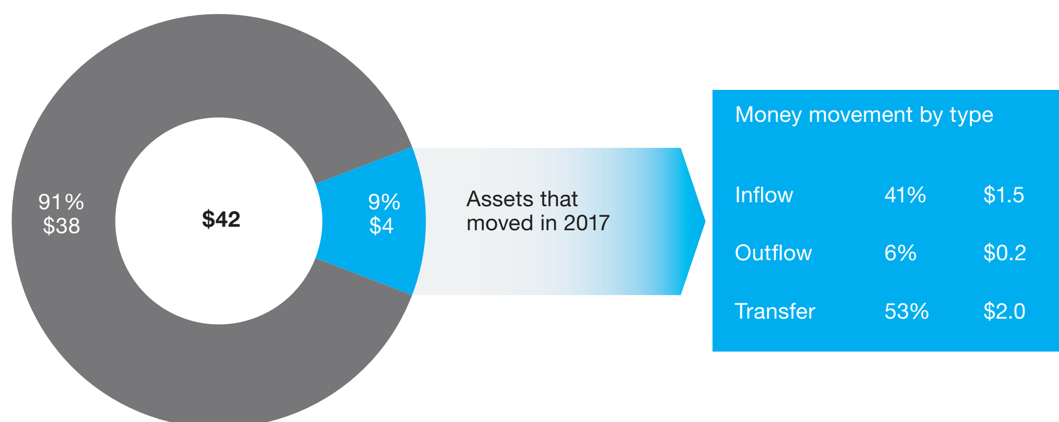
McKinsey estimates that approximately 9 percent of total US investable assets (about $4 trillion) were set in motion in 2017, with the largest driver being transfers between firms (roughly $2 trillion, 95 percent of which is attributable to voluntary client transfers, and 5 percent to advisors switching firms) (Exhibit 6, next page). Assuming a relatively stable competitive landscape (that is, no large, external disruptor enters the industry), capturing an outsized share of these flows will require superior execution across a core set of business drivers, including:

- *Target the right person with the offer at the right time using advanced analytics*
- *Serve clients across their entire financial life:* Deepening client relationships, supported by teams and access to a broad suite of products and services to more fully satisfy client needs. Beyond the offering, firms will need to invest in new capabilities in the field, access to "360-degree" customer views and data-driven sales and service recommendations
- *Reduce client attrition* by delivering superior client experiences and leveraging near-real-time monitoring of client behavior and predictive models to identify and proactively address clients with a high likelihood of churning

Exhibit 6

Trillions of dollars are set in motion each year in the US, more than half the result of transfers between firms.

Total investible household assets
$ trillion



Source: 2018 McKinsey Affluent Insights, n=19,893

- *Recruit the right talent* by using predictive models to target advisors with a high propensity to grow, while developing a new generation of advisors to meet the needs of a more diverse, tech-savvy, and socially conscious generation of clients

- *Reduce advisor attrition* with effective rewards and recognition practices, and leverage analytics solutions to identify and proactively address the drivers behind top talent attrition

- *Reinvent the pricing model,* moving towards more consultative management fees and enhancing pricing discipline with tools and analytics

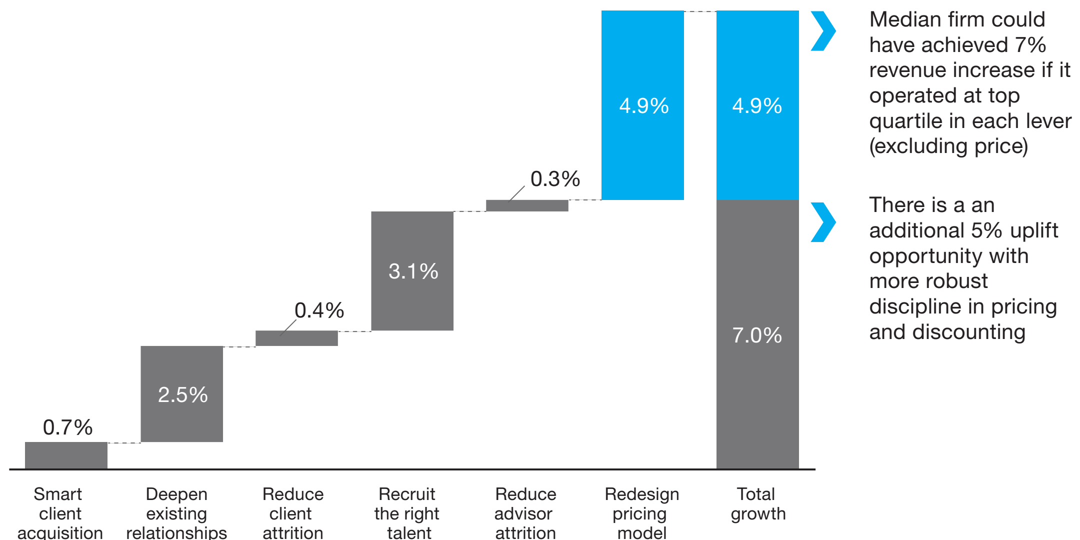
The potential returns from taking these actions can be significant: McKinsey research shows that median performers could achieve a 7 to 12 percent increase in annual revenue growth by operating at top-quartile performance across these six levers (Exhibit 7, next page). Firms that act now, from what is likely a position of financial strength, have the opportunity to build their capabilities across these dimensions, setting themselves up to emerge as winners in a future environment in which performance is primarily dictated by the ability to grow organically and cost-effectively, and not so much by external tailwinds.

In a more radical scenario, in which a leading "platform" tech company enters wealth management at scale, wealth managers will need to fundamentally rethink their business models. The entrance of a platform firm would dramatically change the market structure while further raising client user-experience expectations and potentially shrinking profit pools with innovative pricing models. To succeed under this disruptive scenario, wealth managers need to understand the

Exhibit 7

Almost all firms have an opportunity to accelerate growth.

Potential uplift in revenue growth for the median firm, 2017



Source: PriceMetrix; McKinsey Global Wealth & Asset Management Practice

platform approach—that is, going after high-margin businesses and winning by solving the pain points customers experience with incumbents. The more pain points wealth managers can alleviate in the near future, the better positioned they will be to fend off disruptors with technological and capital advantages.

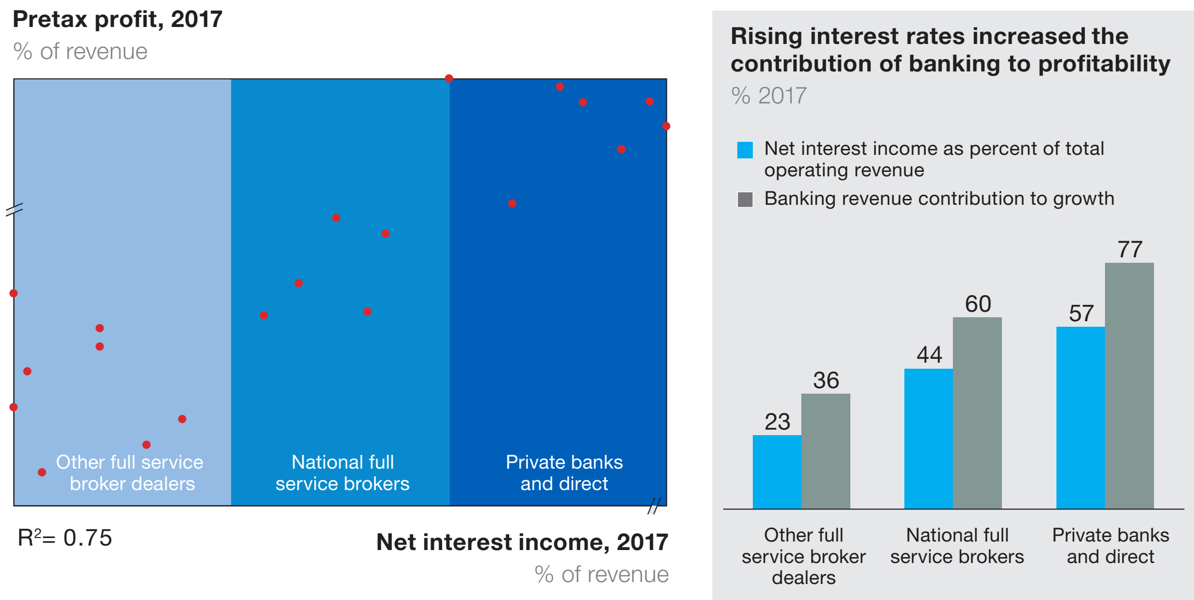
3. Will banking revenue continue to be a performance enhancer or will it become the key performance driver?

The Federal Reserve's three interest rate hikes had a major impact on industry performance in 2017, contributing $2.6 billion to US wealth management profit pools, and making winners of firms who placed their bets on banking. Not surprisingly, private banks and direct channels, who enjoy the highest penetration of banking products across their client bases, reaped the biggest benefits (Exhibit 8, next page).

From a competitive standpoint, having a robust holistic offering that covers both investments and banking is becoming an increasingly important strategic pillar for both wealth managers and banks, leading to a convergence of the two businesses. As digital tools break down barriers between account types, more clients are thinking of their financial lives in an integrated way and showing a preference for simplicity that will lead them to consolidate relationships with fewer financial services firms (if not one). Moreover, banking needs occur before wealth management needs and can thus be an important hook for new client acquisition. Therefore, wealth management firms without banks may run the risk of becoming cost uncompetitive, as

Exhibit 8

Profitability is highly correlated with banking revenue in a rising interest rate environment.



Source: 2018 McKinsey North America Wealth Management Survey

banking products are a major driver of industry economics.

4. How will the role of asset management partners evolve?

Shifting industry dynamics also present an opportunity for wealth managers to rethink and optimize relationships with their asset management partners. While some retail asset managers have invested in building direct-to-consumer channels (e.g., Vanguard), the majority remain focused on winning the battle for narrowing product shelf space, model portfolio inclusion, and staying top-of-mind with advisors. Beyond developing next-generation distribution capabilities (e.g., data-driven advisor segmentation, digital marketing, advanced analytics tools for wholesalers), asset managers are investing in resources to improve advisor experience and engagement, such as portfolio construction tools and practice management support. In this context, there is opportunity for wealth managers to engage in dialogue and proactively shape the evolution of their relationships with product manufacturers.

5. How will the share of robo-, remote-, and advisor-led business models evolve across client segments?

While robo and remote advisors still represent only a small fraction of the industry, recent growth rates have been remarkable, with total client assets growing by 90 percent to $210 billion in 2017. Importantly, however, the digital attackers who were first to offer robo-advisor services have been crowded out by innovative digital-first incumbents, raising questions as to what the future holds for this segment.

As business models evolve, firms will need to think beyond traditional channel definitions in developing competitive and viable offerings tailored to the needs and financial profiles of each client segment they aspire to serve. This may include implementing next-generation client- and advisor-facing technologies, recalibrating product offerings and service levels, and deploying new pricing models and go-to-market strategies. Whether leading with a high-touch human advice model focused on the higher end, or a digital model targeting less affluent segments, taking a customer-centric view will be critical in developing a compelling value proposition that attracts and delights investors.

6. Will clients of the future look like the clients of today?

US baby boomers today range from 50 to 70 years in age. They control some $15 trillion in financial assets, which are expected to be worth $20 trillion in ten years. Some of these assets will pass to the next generation. In the interim, women, who tend to be younger and have longer life expectancies than their husbands, will increasingly gain control of household wealth as their spouses pass away.

While much has been written about the expected wave of intergenerational wealth transfer, the impact of interspousal wealth transfer should not be overlooked. Today, when a first spouse dies (typically the male in a traditional family), 60 percent of household assets leave the financial institution that had supported the couple with their investment and retirement needs. And this switch from one financial services provider to another typically occurs within 12 months of the first spouse's passing. The implication should not be a surprise: women have preferences of their own and they act on them. Financial firms should thus reorient today to make women central to the client experience, and to capture their hearts and minds well before they start to explore alternatives.

7. What can wealth managers learn from technology-led offers about how to enhance client experience?

As in all industries, wealth management client expectations are rising at an unprecedented rate. Standards for convenience, selection, personalization, and transparency are being transformed by innovative disruptors and platform firms from within and outside financial services (consider, for example, Amazon's one-click ordering, same-day delivery, and suite of over 500 million products, all accompanied by customer reviews).

In parallel, new business models from startups (e.g., Acorns, Robinhood) and innovative incumbents, coupled with the threat of market entry by digital platforms such as Amazon and Google, are further challenging the status quo and raising the bar for client experience.

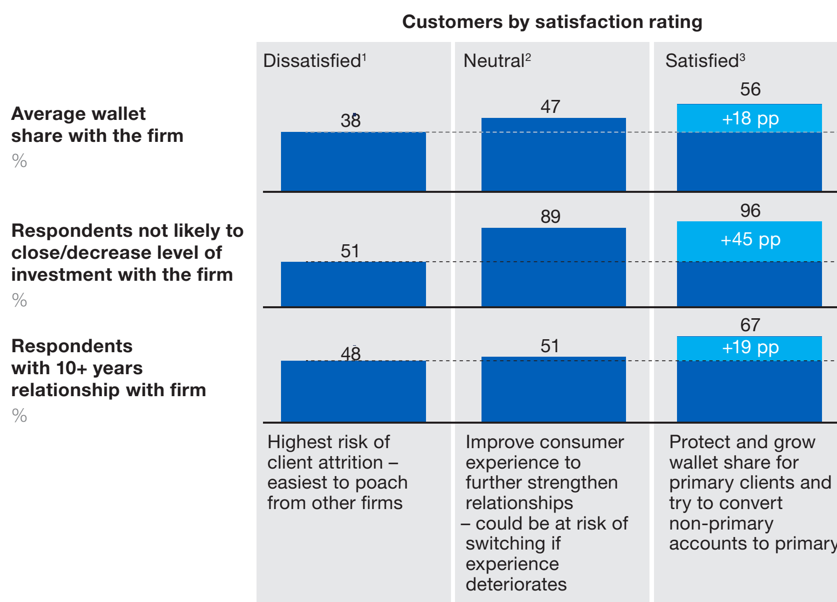
Superior customer experience (CX) can become a critical source of differentiation and, in turn, translate into tangible financial benefits. According to McKinsey's 2018 Affluent Consumer Insights 360 Survey, firms with high levels of consumer satisfaction enjoy materially higher wallet share and consumer loyalty (Exhibit 9, next page). As a result, leading firms are making targeted investments in CX initiatives, leveraging advanced analytics to identify and prioritize customer journeys and specific touch point enhancements that drive loyalty and engagement. In contrast to technology-led offers, these initiatives are not limited to digital experiences, but extend to in-person and telephonic interactions as well.

8. Will technology drive a step change in margin profiles?

Despite milestone developments in technology—robotic process automation (RPA), smart

Exhibit 9

Client satisfaction translates into higher wallet share and lower likelihood of transfering money to another firm.



[1] Customers with satisfaction rating 0-3: 2% of total.
[2] Customers with satisfaction rating 4-7: 28% of total.
[3] Customers with satisfaction rating 8-10: 70% of total.
Source: 2018 McKinsey Affluent Insights, n=19,893

workflows, machine learning, advance analytics, natural-language processing (NLP), and cognitive agents—many wealth managers have struggled to take full advantage. Front-end digital enablement has been largely sub-par, with tech and operations platforms in desperate need of modernization. Across the industry, firms remain saddled with deferred IT maintenance costs, manually intensive processes, and complex servicing arrangements leading to stubbornly high operating costs, reduced (and sometimes negative) operating leverage, and unrelenting margin pressure.

At the same time, some firms have started to capitalize. For example, firms across the globe are harvesting the power of NLP-enabled chatbot technology (e.g., TD Ameritrade and, in Asia, Credit Suisse Private Bank) by integrating customer support into social media platforms (e.g., Twitter, WeChat). NLP and other technologies not only lead to efficiency gains, but also result in superior customer service and experience. Leveraging the full potential of new technologies can reduce support function headcount by as much as 40 percent and, in turn, result in a step change in margin profiles.

The US wealth management industry is poised for growth over the next decade. The bifurcation of wealth is expected to persist, and new scalable and cost-effective service models will allow wealth managers to serve new, historically underserved segments. Given the positive outlook and highly attractive profit pools and margins, it

is only a question of when technology-led firms, either existing incumbents or platform firms, try to disrupt the status quo. The new winners will likely not enjoy margins as high as the industry boasts today, but they will compensate by serving a significantly larger number of clients in a cost-effective way. Thus, while it may be tempting to sit back and enjoy the ride, executives should be closely examining and rethinking their business models, and taking bold actions to build for success and competitiveness through the cycle and into the future.

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Global Banking Practice
December 2018
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