NOVANTAS STRATEGY & MANAGEMENT

In a growing self-directed market, households have parked trillions of retirement dollars in everyday banking products. How can banks expand their role with these customers?

Banking Strategies for the "Shadow" Retirement Market

BY WAYNE CUTLER

Banks have strongly emphasized retirement-related offerings as they pushed into wealth management in recent years. In an era when workers no longer can count on company pensions, retirement planning and investments meet a compelling customer need.

Though successful, banking expansion into the retirement business has proved problematic in the Great Recession. Despite recent market gains, most households are still hurting on their retirement investments. Meanwhile, wealth management providers are straining to retain customers and rebuild income.

While this story is all too familiar to banks, most are overlooking a major aspect of the retirement business that is sitting right under their noses. In an increasingly self-directed market, U.S. households have parked trillions of their retirement dollars in everyday banking products, such as certificates of deposit and various types of money market and savings accounts.

Often there is little or no effort to consciously manage this "shadow" retirement market by looking to larger customer goals. In turn, efforts to attract and retain this valuable business usually fall well short of their potential. Banks face a huge risk of future outflows as baby boomers retire and begin to draw down these savings.

Most immediately, banks need to investigate their own account base to identify retirement-earmarked product balances and their customer origins. For example, most bank CD portfolios have high concentrations of single-account customers, who can supply more than half of balances yet have only slender ties with the bank.

A serious effort also is needed in the area of product design, so that features and benefits are lined up with retirement-related goals, such as setting up a monthly revenue stream that will commence on a specified date. Longer term, banks will need to build stronger bridges between internal product units, so that wealth and traditional savings product divisions can develop a multi-faceted outreach to shadow retirement customers.

AS SEEN IN
bank investment consultant

HIDDEN IN PLAIN SIGHT

When it comes to financial services centered on "retirement money," most bankers think of assets held in structured product lines, such as

401(k) plans, individual retirement accounts, pension accounts and annuities. Such products constitute a powerful and reasonably well-defined market, built up over a long period of time.

We estimate that U.S. households at yearend 2008 still held more than $15 trillion of retirement assets in structured products. Such assets are divvied up among all sorts of financial services companies, including brokerages, investment and wealth management firms, banks, insurance companies, regional investment advisors and various government and corporate pension funds.

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The banking industry's share of the revenues from the sales, advisory and service activities associated with structured product lines easily ranged from $12 billion to $13 billion in 2008 alone, according to our research. But there's another side to the story.

Increasingly, households have been building up long-term retirement assets in investment vehicles that don't have the traditional product connotation of "retirement." These instruments include certificates of deposit, money market deposit accounts, money market mutual funds, and other types of retail savings and investment accounts.

At yearend 2008, these instruments held an additional $8.6 trillion of assets earmarked for retirement by U.S. households, based on our research. In turn, banks derived from $6.5 billion to $7.5 billion of additional revenues in 2008 from their share of sales, advisory and service activities connected with shadow retirement balances held in everyday investment and savings products. But does this revenue stream receive the same level of care and attention accorded to structured retirement product lines? Definitely not.

THREE-PRONGED APPROACH

Some domestic and foreign banks are already taking steps to more proactively engage shadow retirement customers. These institutions typically follow a three-pronged approach that includes understanding the current involvement with shadow retirement customers, coming up with specific products and customer outreach programs, and pulling together a supportive management and distribution framework.

As a case study of how this works, one regional bank started its investigation with an informal survey process that included conversations with customers, bank branch managers and people involved in selling investment products. Management was surprised by early indications more than two-thirds of the CD and savings balances at this affluent-customer-focused bank were earmarked for retirement.

It also became clear that branch sales representatives were recommending these products primarily to meet sales quotas, and not on the basis of helping customers with their retirement-related needs. This is a typical finding, reflecting the fact that a customer-driven sales approach is more complex and time-consuming, whereas product campaigns are easier to roll out and often prove effective in achieving short-term growth.

Executives at this bank then went a step further by building profiles that included estimates of customers' total retirement balances, including those held at other institutions. While they expected to discover significant balances held elsewhere in structured products, such as 401(k) plans and IRAs, they were surprised to see indications that hefty shadow retirement balances were being held at other institutions as well.

Furthermore, interviews showed that most customers were making independent decisions about where to place their shadow retirement balances, and that some were already planning to withdraw deposits, either to achieve higher returns or to meet various types of retirement needs.

BUILDING INTERNAL BRIDGES

Continuing with the case study, interviews with the retail banking and wealth management units revealed deep divisions between the respective management teams, with lots of rivalry on issues such as control of customer relationships and differences in compensation arrangements. Then in discussing how to bridge this divide, wealth managers played the "regulatory constraint" card, which they said limits the degree of integration between the two organizations.

Following a more detailed review and a discussion with regulators, however, it became clear that coordination barriers were more about misunderstanding than about regulatory constraint. Operating within certain licensing and reporting requirements, in fact, there can be a much higher degree of coordination, both in the manufacturing of hybrid bank/investment products and the distribution and servicing to bank clients.

The bank finally formed a steering committee that included executives from the deposit and investment advisory lines of business; distribution; technology and human resources. This group was asked to develop a multi-faceted strategy to grow retirement assets at the bank, including structured and shadow retirement accounts.

Ultimately the steering committee decided to focus on two areas: products and distribution. Then the group launched an international search for progressive examples.

One interesting product innovation turned up at Hang Seng Bank Ltd., one of the best performing banks in Hong Kong. One of Hang Seng's Capital Protected Investment Products combines the upside of gold bullion with the safety of term deposits.

Another example surfaced at Dublin-based Bank of Ireland Group, which had introduced Golden Years Deposits. Aimed at customers over 60 years old, this savings product allows customers to earn high fixed-term rates while retaining the flexibility to withdraw up to 25% of principal once during the deposit's term, penalty free.

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These examples were combined with a lot of other research to create some new CD products specifically targeted to shadow retirement accountholders, with the goal of appealing to investor requirements such as downside protection and account flexibility.

Turning to distribution, the team wanted to forge strong ties between the banking and wealth divisions. To this end they created a standing committee, composed of bank and wealth managers, that was charged with creating a joint marketing agenda, including customer programs and goals for both bank and wealth products. This was a shared agenda on which both the bank and wealth teams would be measured.

This committee now meets quarterly to review progress and make course corrections as necessary, and the initiative is supported by a central marketing group that designs the products and produces the customer calling lists and programs.

BRANCH SALES STRATEGY

An ongoing issue is how to sell investment products in bank branches. In addition to building necessary expertise, there is the challenge of establishing an advisory rapport that is comfortable for customers and cost-effective for the bank. For the bank in this case, the answer was a private banking "lite" (PBL) model that is built around designated staffers.

In most branches, the bank decided that there should be a representative to anchor investment-related inquiries and make sales and referrals. Most are licensed brokers who can sell investment products directly, and the rest are bankers who can build financial plans and then execute transactions with the help of specialists elsewhere in the organization. All receive training on how to onboard the customer, how to enter into a broader financial planning dialogue, and how to prepare a formal financial plan.

This arrangement provides a comfortable way to introduce new CD products that are geared toward shadow retirement customers. It also helps the bank to play a stronger advisory role as customers consider their total mix of retirement investments. In many cases, there are opportunities to advise CD customers on a larger range of investment vehicles that will assist in reaching retirement goals.

To ensure that the program was economical and flexible, the bank created a variable pricing structure, which, for example, included basic planning fees that could be waived for customers with certain asset thresholds. A small team of licensed specialists was set up to provide call center service for PBL customers, for items such as account inquiries and remote transactions.

To support the initiative, traditional commission-based sales incentives were replaced with a salary-plus-bonus arrangement that hinges on growth goals, such as assets under management and new accounts with financial plans. And the

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bank invested in new software for financial planning and customer relationship management.

As a starting point, the bank focused on single-CD account holders, with the goal of strengthening customer relationships, introducing retirement-tailored CD products and also introducing other investment alternatives, such as fixed and variable annuities. Nationally, banks have had mixed results in expanding retail banking relationships to include investments. Results range from as little as 2% to as high as 20% penetration of the retail customer base, according to our research. This bank is advancing toward its goal of cross-selling investments to at least 10% of its retail customers.

Such progress will be critical going into 2010. After fleeing into CDs and other savings accounts, safety-conscious investors will be more likely to reconsider their options as the market rebounds and investment yields look more promising. Among banks, the winners in this emerging scenario will be the ones that can look beyond individual deposit and savings products to the current and long-term needs of shadow retirement customers.

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