

Bank investment products may never gain momentum with mass affluent customers. Yet this group has other major retirement needs that fall right into the strike zone for banks.

Mass Affluent Strategy: Tilting from Investments to Payments

BY WAYNE CUTLER

A continuing banking aspiration in wealth management is to reach through the branch network to tap the vast under-served market of mass affluent customers. The goal is to sharply increase the sale of investment products and gain market share in a field that long has been dominated by brokerage and investment companies.

It has been a long hard road, with few success stories. But major banks cling to the belief that their vast regional branch networks will finally gain traction with investment products and advisory services. The apparent success of the former Wachovia Corp., for example, is often cited as a model of what other banks would like to achieve.

For many players, however, the time has come for a major course correction. As underscored by a recent national survey by Novantas and Informa Research Services, the banking

industry has gone nowhere in building its image with investors. Overall, only 12% of consumers prefer to keep their investments with a bank. It is time to recognize that most banks will never significantly penetrate the investments industry.

Instead, for many banks, the better path will be to double down on a central strength – payments. Only a select few players will be able to substantially increase their role in helping people to build investment wealth during their working years, and those that do will focus on upper-echelon segments. For mass affluent households, by contrast, there is plenty of room for banks to play a larger role in helping with budgeting and cash management needs, especially in retirement.

The enormity of customer need is underscored by survey responses indicating that two of every five mass affluent households expect to outlive their retirement resources. More than a third of this group will outlive their personal resources by up to a decade. In such pressing circumstances, there are two areas where banks can play a major role in serving mass affluent customers.

One is household budgeting and cash management: providing the information, tools, advice and products that will help with the careful management of resources

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and expenses in pre- and post-retirement years.

The other is what might be termed staged disbursement: converting investment assets into monthly cash streams that can be used to supplement retirement budgets, while ensuring that unused funds continue to grow.

Banks should not be particularly surprised to learn that they don't have a clear field. Brokerage and investment companies are eager to build and retain household balances as families shift investments to vehicles more suitable for use in meeting near-term retirement spending needs. Thus while banks currently occupy the high ground in payments, they need to take action now to defend their strong position.

MASS AFFLUENT SEGMENT

The mass affluent customer segment typically is defined as those households having between \$100,000 and \$500,000 of "investable wealth," exclusive of formal retirement accounts, insurance policies and home equity.

The attraction of this group reflects the huge resource pool that it controls – roughly \$13 trillion of retirement assets and nearly \$7 trillion of other investments as of September 2010. All told, the combined \$20 trillion represents an estimated 47% of all U.S. household retirement and investment wealth. One drawback in serving this group, however, is that balances are splintered across nearly 24 million households, meaning that while the collective opportunity is huge, it can be a modest proposition on a case-by-case basis.

Many mass affluent customers are not getting the advice they need to anticipate and fulfill their financial needs in retirement. This group has either been over-served by the branches, which primarily focus on selling basic savings products, or under-served by registered investment advisors, who sell slightly more advanced long-term investment

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products, such as fixed and variable rate annuities.

While the common banking wisdom favors "staying the course," increasingly the whole mass affluent strategy seems defunct. All the fuss over distribution overlooks a much larger problem for banks, which is a profound lack of brand resonance in the area of investments. In the recent Novantas-Informa national survey, for example, two-thirds of mass affluent respondents said they prefer not to keep investments with banks, and another 23% said they would do so only selectively.

Some banks have tried to jump-start their wealth strategies by acquiring or allying with brokerage and investment firms. The goal is to leverage the valuable brand names, customer connections, distribution networks and skill sets that such firms can provide. Even this is not a sure proposition, as prior acquirers have learned.

For most banks, branch-delivered wealth management for the mass affluent is a losing proposition and should be recognized as such. The tide is not going to turn. At this critical juncture, however, banks should not let their fixation on investment products cause them to lose sight of larger mass affluent customer needs.

The importance of developing new banking products and services for this segment is underscored by the fact that over the next five years alone (2011-2015), roughly 1.8 million mass affluent households are expected to enter retirement. This group will carry roughly \$550 billion of investment assets into retirement – along with substantial additional resources in structured retirement products and other savings. People in this group on average can expect to spend roughly 17 years in retirement and will have an ongoing need to withdraw funds to manage expenses.

The institutions that win the opportunity to manage this payment flow for retirees will generate substantial revenues from keeping idle balances in low interest-bearing accounts, and from providing payment services. And the opportunity will grow as additional waves of baby boomers retire.

PRODUCT AND SERVICE INNOVATION

Although it is not always recognized, banks already play a prominent role in the retirement market. As detailed in Novantas research, mass affluent customers as of September 2010 had approximately \$11 trillion dollars of retirement-earmarked funds parked in "shadow retirement investments" –

everyday banking products such as checking and savings accounts, and certificates of deposit.

There will be a continuing customer orientation toward banking products, both in preparation for retirement and as receptacles for investment resources as they are drawn down for use in meeting near-term household financial needs. But this entrée cannot be taken for granted. Winning banks must go beyond the passive supply of basic products and become active partners in helping customers to cope with their financial circumstances and achieve their objectives.

Budget management. As underscored by the Novantas-Informa survey, mass affluent households tend to be less confident about their retirement plans. Roughly one third say they will retire later than planned, and many believe they will outlive their resources. One implication is that millions of mass affluent households will have a permanent need to manage their monthly and annual budgets quite carefully, not only during retirement but during their remaining working years as well.

To meet this emerging need, early innovators are deploying online toolkits that attempt to provide a complete household financial dashboard. In some cases, providers are seeking fee revenue generation; in other cases these packages are being fleshed out to capture cross-sell possibilities that surface as households clarify their positions and make consequent savings and borrowing decisions. Current examples are as follows:

- ❖ As provided at no charge by Bank of America Corp., the “My Portfolio” online planning tool allows the user to develop a consolidated view of asset and debt accounts, including accounts not held at BofA. Along with calculating household net worth, the tool allows users to view account details, create budgets and analyze spending and savings

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patterns. There is both a consumer version and a small business version.

- ❖ At *mint.com*, customers can download information on balances and transactions, and do so by category, and they can elect to receive daily automatic updates. A charting function allows users to easily create graphical representations of spending, income, balances and net worth. The site also makes personalized recommendations on financial products (and generates revenue for the provider through lead generation).

- ❖ At *mvelopes.com*, customers can view real-time information on all of their accounts and balances, set budgets, and analyze spending in detail. Mvelopes charges a \$190 fee for a two-year plan; \$130 for a one-year plan; and \$40 for a quarterly plan.

We fully expect to see a proliferation of competitive offerings over the next few years. And we believe that bank-branded services will have an intrinsic brand advantage in attracting customers and inspiring user trust and confidence.

Staged disbursement. In retirement planning, advisers and customers pay a lot of attention to future payout dates, specific points in time when accumulated wealth is transferred out of long-term investment vehicles and becomes available to meet current spending needs. While such events may mark the end of one type of longstanding financial services relationship, they also can mark the beginning of new relationships.

Specifically, most retirement households reach a stage when they primarily want their financial products to generate steady monthly income – stringing out remaining balances as long as possible to cover living expenses. In turn, this creates a multi-year need for a different category of retirement products centered on the staged disbursement of investment assets. Current examples are as follows:

- ❖ As provided by Fidelity Investments, “Income Replacement Funds” are specifically designed to facilitate the disbursement of retirement savings. Funds provide professional management of assets and the amount and timing of withdrawals. Customers can specify the length of period over which funds will be liquidated. Typically, monthly payments are intended to keep pace with inflation, while the remaining portfolio continues to grow in support of future monthly spending needs.

- ❖ Offered by Northwestern Mutual Financial Network, the “Deferred Variable Annuity” allows

assets to accumulate tax-free, and will only start disbursement at a future date set by the customer.

As is obvious with these two examples, some non-banks already are alert to the opportunities in the staged disbursement retirement product space. Our research indicates that this is a huge and growing market. Along with re-packaging and more aggressive marketing of current products, banks need to innovate in this space if they are to avoid having investment and brokerage companies siphon away valuable balances and customer service opportunities.

SETTING PRIORITIES

Looking out over the next few years, banks have a lot of work to do in re-tooling wealth strategies. Questions about products and distribution are taking center stage at a time when many institutions need to take a fresh look at emerging customer needs.

Customer research is the essential first step. Many banks need to learn far more about the composition of current balances, in terms of retirement-earmarked household resources held in everyday products. They also need well-considered estimates of “share of wallet” and the extent of total household wealth. As progressive banks begin to close this knowledge gap, they are gaining a far better grasp of the total customer opportunity (“why take action”) and clarifying priority customers (“where to take action”).

The question then turns to research-based innovation. What are the future needs of mass affluent customers, especially in budgeting and staged disbursement? Considerations include the basic value proposition (fee revenue generation; cross-sell), product design and bundling, packaging, competitive differentiation and targeted marketing. This is a team developmental effort centered on establishing a new banking center of gravity in serving the mass affluent customer segment.

Another priority is refining distribution strategy. The cost basis of branch distribution remains high. And customers are increasingly receptive to electronic alternatives. One possibility is a “virtual hub-and-spoke” delivery strategy that feeds referrals to efficient central teams of credentialed investment professionals. Such teams are already being used to supplement branch networks, and they can be effective in supporting call center and online channels as well, especially for the less profitable mass affluent segment.

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There is also much more that can be done at the ground level within branches, despite setbacks with investment products. Today in many branches, for example, there is a high concentration of single-product customer relationships centered on certificates of deposit earmarked for retirement. By repackaging CD products and restructuring the sales dialogue and staff incentives, progressive banks are strengthening the relationship context with mass affluent customers, improving cross-sell and customer retention.

SEGMENT-BASED MANAGEMENT

Turning to management implications, we are at the onset of an era in which bank internal organization increasingly will be based on customer segment, as opposed to individual products and distribution channels. This approach will be needed to unlock emerging opportunities with the mass affluent customer segment.

For example, one East Coast bank 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.

Importantly, such coordinated efforts need to be based on a view of the emerging market, and not limited to better execution of current strategies and

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tactics – many of which have come up short and probably will continue to do so. As the Novantas-

Informa study indicates, investment products may never deliver hoped-for momentum with mass affluent customers. Yet this customer group has important categories of retirement needs that fall right into the strike zone for banks. Banks that follow through on this opportunity will gain significant long-term competitive advantages in serving the mass affluent customer segment.

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