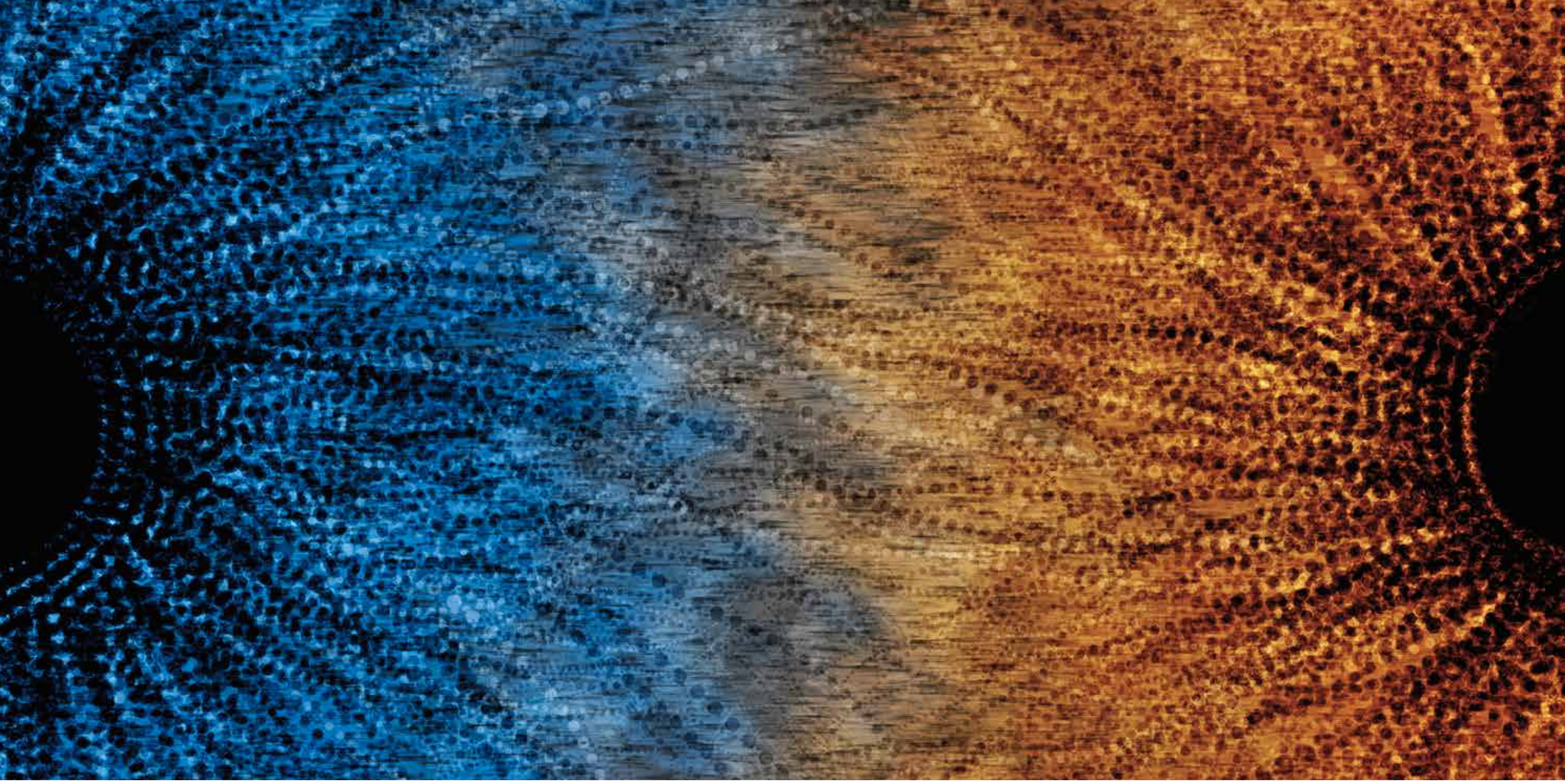

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Managing mergers: A conversation with Rob Leary

The president of TIAA-CREF Asset Management talks about why the industry is likely to see more tie-ups, how to prepare for big deals, and why finding growth depends on what you're good at.

Onur Erzan and Bryce Klempner

Rob Leary joined the Teachers Insurance and Annuity Association of America–College Retirement Equities Fund (TIAA-CREF) in June 2013. Less than 18 months later, the former lawyer and veteran asset manager had helped his company close the $6.25 billion acquisition of Nuveen Investments. This May, Leary spoke with McKinsey's Onur Erzan and Bryce Klempner about the state of the industry and the future of M&A.

McKinsey on Investing: *You've been with TIAA-CREF for about two years, the latest stage in a long career in global asset management. What do you see as the major trends in the industry today?*

Rob Leary: The biggest change in recent years is the shift from active to passive asset management. There's been a proliferation of exchange-traded funds more broadly, too. But even more important—particularly from a revenue perspective—is the move to alternatives, both liquid and illiquid. By 2020 or so, alternatives will be about 15 percent of global assets under management but about 40 percent of industry revenues. I don't think this will change soon; alternative investments will continue to play a huge role in the industry.

More broadly, I think we will see less focus on beating benchmarks and more focus on helping clients meet their financial goals. Given the events of the past 10 or 20 years, people are starting to realize that what actually matters are the outcomes, not how well you perform versus a benchmark.

McKinsey on Investing: *And how about from the distribution side? Do you see any major shifts there?*

Rob Leary: Well, it depends on what model you have—whether you're focused on retail or institutional investing or you're direct to consumer—but, generally speaking, I think the industry is becoming much more research driven and much more objective. We're seeing open architecture across the board. The industry is becoming more consolidated; nearly every gatekeeper is using similar filters and methods of screening investor performance. So your organization has to be professional—efficient, farsighted, continuously improving.

McKinsey on Investing: *These are big changes. How are they affecting the CEO agenda?*

Rob Leary: At the end of the day, it's about making sure you're increasing your market share. The CEO of any investment-management organization should first and foremost focus on risk-adjusted investment performance over the long term. You need to perform well, and you need the framework to do it on a regular basis.

That's not enough, of course. Companies also need the right mix of strategies and products, and they need the right tools in their toolbox. And not just for today—they need to be well positioned for where the market is going. To that point, most CEOs are probably thinking about alternatives, wondering if they can be in this space, if they should be, and where they can be especially strong. That's a big shift for CEOs, I think.

On the distribution side, CEOs need to make sure they have the right expertise for the markets they're in. There are certain areas, such as large market cap in the United States, that have seen a net outflow on the active side for a while now, which means that to win, you either have to gain market share or have truly amazing performance. If you don't have either of those things, you should be thinking about other markets you might want to enter.

And then there's scale. Small, very specialized managers can stay small, but only if they have great investment performance. Large companies have to perform well, of course, but they also have the benefits of scale. I think it's the in-between managers that should be asking where to go and where to focus.

Finally, the regulatory environment is much more complex than ever before. The Securities and Exchange Commission is getting much more involved in a number of issues, including cybersecurity. Foreign regulators are involved in issues such as compensation. And CEOs are thinking about things like SIFI[1] designation, too. So yes, I think regulations have created a big shift in the CEO agenda.

McKinsey on Investing: *What about talent—is that also on the CEO agenda? Is it getting easier or harder to find and retain the right people?*

Rob Leary: During and immediately after the financial crisis, there wasn't much movement in terms of talent. That's changing, especially in alternatives and distribution—there's a huge focus on talent in both of these areas right now. Compensation is certainly an important part of attracting and retaining the best people, but there's more to it than that. If you want your team to stay, you have to give them the resources and freedom they need to succeed. This is a big part of our talent proposition. Our investment and distribution teams are compensated fairly, as long as their performance is solid. But equally important, we let our people focus on what they do really well, and we make sure they have the resources they need to do so.

McKinsey on Investing: *Another CEO topic might be M&A. You've led TIAA-CREF through a*

Rob Leary

Vital statistics
Born March 20, 1961, in Brooklyn, NY

Education
JD, Fordham University

BA, Union College

Career highlights

TIAA-CREF
(June 2013–present)
Executive vice president
President, asset management

ING
(2007–12)
Chairman and CEO, ING Investment Management Americas

AIG
(1995–2007)
Executive vice president, AIG Financial Products
President, AIG Financial Securities

JPMorgan
(1990–95)
Vice president

White & Case
(1986–90)
Attorney

Fast facts
Member, board of directors, AmeriCares

Director, Intact Financial Corporation

Member, board of directors, Friends of Acadia

Former director, College Year in Athens; Convent of the Sacred Heart, Greenwich; ING Foundation; Long Island Soundkeeper; Mystic Seaport; and Pomona Capital

couple of important transactions. What trends are you now seeing? How do you see mergers and acquisitions evolving?

Rob Leary: There are a number of players in the middle, the in-between managers, that don't quite have the scale they need. They have to either shrink or grow. Shrinking is hard, and so is growing organically. So we're going to see more and more M&A moves as small as "lift-outs" and as big as major acquisitions. M&A offers lots of benefits in addition to scale. It can help companies expand their offerings into passive investments, exchange-traded funds, target-date funds, alternatives—this is where the market is going, and every investment company should have them or at least have given a lot of thought to why they don't. M&A can help fill other gaps, too: geographies where you don't yet have distribution, for example. But you can't let M&A interrupt your own investment and distribution platform, or that of your new partner, and you can't let it disrupt your culture.

McKinsey on Investing: *Ultimately, is the industry's move toward consolidation more about scale or more about scope?*

Rob Leary: It depends. Sometimes it's about scale. For example, to win in US mutual-fund markets, you have to be really big or a smaller play with excellent investment performance. But even for very small companies, it's getting harder—for players outside of the top quintile, at least—to get onto platforms. Ultimately, nearly everyone in this market will need scale. But scope matters, too. Sooner or later, if you want to be a global asset manager, you need a business model that can survive different cycles and trends. Increasing scope and diversifying can diminish the overall risk to your business.

McKinsey on Investing: *You mentioned that an important part of M&A is preserving culture and values and making sure investment platforms continue uninterrupted. How can companies do that?*

Rob Leary: First and foremost, everyone has to agree that the client comes first. Second, the organization has to operate with integrity. This means, among other things, valuing your own people and treating them well. And it's critical that the new organization operate as one team—not on a star system. Some managers like the star system, and in some cases it can work. But it means you're relying on a small set of individuals, which I think is very risky. Their performance can take a turn for the worse, or something can take them out of the picture. I don't think that's a great proposition for clients or for an asset-management business.

McKinsey on Investing: *Looking back at your recent deals, is there anything you'd have done differently—or that you'll do differently next time, if there is a next time?*

Rob Leary: That's a great question. We're in the early days of our acquisitions of Nuveen and of the Henderson Group's real-estate business, but both integrations are going well so far. I think this is in large part because we worked hard to prepare. We had a dedicated team of internal people—really talented people who could focus on these mergers—so our investors and our distribution folks could continue to do their jobs.

We've also been lucky. So far there haven't been a lot of surprises. We didn't lose any clients in either deal, and we didn't lose any key individuals at TIAA-CREF or the organizations we acquired. Things went well with the regulators and the rating agencies, and we had buy-in from just about everyone. Of course, no matter how many checklists you make, no matter how many advisers you have on your team, little things can always slip through the cracks. It's more about making sure the big things don't. We did our own debriefs after each transaction: what went right, what went wrong. The things that went wrong were, I think, pretty minor.

Another point—it's an old adage, but it's surprising how valid it is—is that you have to manage everyone's expectations from the outset: the companies', the boards', the mutual-fund boards', and so on. You have to be honest and open about what each should expect. You have to communicate early and often.

McKinsey on Investing: *What about functional challenges to M&A? Are there particular parts of the business that are especially difficult to integrate with one another?*

> "No matter how many checklists you make, no matter how many advisers you have on your team, little things can always slip through the cracks. It's more about making sure the big things don't."

Rob Leary: It's especially difficult for monolithic managers—huge, fully integrated companies—to acquire businesses. And it's hardest of all when there's a lot of overlap. You have to integrate investment teams, distribution teams, middle and back offices, and so on. That can cause a lot of anxiety among employees, investment consultants, and investors. Maintaining investment performance in that environment while keeping sales and asset retention high can be challenging. Nuveen was a very large acquisition for us, but our business models were quite complementary with regard to both investments and distribution. We didn't have a lot of overlap. We're a multiboutique manager and Nuveen is a multiboutique manager, so it was a good fit—our platform fit well with theirs.

McKinsey on Investing: *Do TIAA-CREF and peer companies have an M&A mind-set at this point? Are firms waiting for the right thing to come along, or are they taking a proactive stance?*

Rob Leary: I don't see us as a serial acquirer, but we're certainly always looking to fill gaps in our investment strategy, and we are always looking to expand or enhance distribution. We look for geographic opportunities, too. So I do think we'll continue to be active. We just launched a team dedicated to midmarket loans, and we think they'll do great things. The timing was right. It was an area where we needed more heft, and the move was complementary to Nuveen's Symphony affiliate, which invests in debt equity across the capital structure, and our private credit platform as well. We will continue to look for opportunities, but our primary focus right now is making sure the Nuveen and Henderson acquisitions continue to go well.

McKinsey on Investing: *TIAA-CREF aside, do you expect multiboutiques to be more active acquirers, or will it be the monolithic firms?*

Rob Leary: I think we'll see a bit of both. Even if a multiboutique is confident that it has everything covered, that doesn't necessarily mean it's firing on all cylinders. So it's certainly going to look for M&A opportunities. As for monolithic firms, very few already have enough scale and size and scope, so M&A is on their agendas, too. And as we discussed, M&A is especially important for those in the middle.

I think we'll also see a lot of dislocation. We've seen it already with banks and bank-owned asset managers that have had to divest from certain types of activities because of the Volcker rule or other regulations. Other macroeconomic and regulatory factors are going to cause managers to sell some really appealing properties. That's going to present opportunities for both monolithic firms and multiboutique shops.

McKinsey on Investing: *What about wealth managers? Do you think they'll get back into asset management?*

Rob Leary: It's a good question, but I think the answer is no. Given the regulatory environment and the industry's overall direction, wealth managers will be more successful by embracing open architecture and becoming more research driven. It may be more profitable to have proprietary funds in their stable, but that brings increased scrutiny.

McKinsey on Investing: *What about domestic versus international? Are there any places where you expect to see more or less M&A?*

Rob Leary: It's important to remember that it's not just about finding the right regions. It's about finding specific growth opportunities within those regions. Sometimes it's institutional, sometimes it's retail, and sometimes it's something in between. It could be defined-contribution investment only or the Afores pension system in Mexico or something else entirely.

You have to look at your skills and capabilities. For example, US defined contribution is growing, so if you have the right products and strategies, that's a really appealing place to be. For other companies, that may be a terrible move, and it would be better for them to focus on institutional defined benefit, even though it's shrinking. If you have the right thing for the customer, whether it's liability-driven investing or solutions for defined-benefit plans in the current macroenvironment, go there. Sources of growth are highly specific to each manager.

That said, one area that we think will continue to grow, both in the United States and abroad, is real assets—infrastructure in particular. The developed world needs to replace a tremendous amount of infrastructure, and a lot of the developing world needs to build out theirs. That's an area we are focusing on, and I think other managers will focus on it as well.

McKinsey on Investing: *One last question, about the macroenvironment. Asset prices are on the rise, and the idea that we might be approaching a top is gaining ground. Do you have a sense of what might happen next, and how are you preparing for that?*

Rob Leary: Asset managers like us are well diversified across equities, fixed income, and even other asset classes such as commodities, currencies, and the like. We're in the United States and in developed and emerging markets around the world. We're in hedge funds and private equity and real estate and other real assets. So we feel like we have a well-diversified portfolio that could weather a serious storm.

This is such an unprecedented time, particularly because of central-bank investment. We've seen quantitative easing in the United States, in Europe, and in Japan. We're not complacent at all about what might happen. This feels like uncharted waters, and I've been in the business for 25 years. We're focusing on risk management, and we're sticking to our knitting. No matter how diversified we are, we know we would feel a significant market disruption, as would all managers. But we like to think we will be nimble. We're focused, and we have tools that will help us adjust if we need to. ■

[1] Systemically important financial institutions; this designation by regulators requires greater oversight.

Onur Erzan (Onur_Erzan@McKinsey.com) is a director in McKinsey's New York office, where **Bryce Klempner** (Bryce_Klempner@McKinsey.com) is a principal.