

Wealth management in an era of robots, regulation, and new money

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By redirecting focus, wealth managers can successfully respond to challenges brought on by digital disruption, demographic shifts, and tighter regulation.

Wealth managers have seen their fair share of ups and downs in recent years, and while challenges remain, advisers can drive business and growth by paying attention to demographic segmentation, how investors are using technology, and changes in regulation. In this episode of the *McKinsey Podcast*, Simon London first speaks with PriceMetrix chief customer officer Patrick Kennedy and McKinsey partner Jill Zucker about the North American wealth-management industry; he follows that with a discussion with senior partner Joe Ngai, on the industry in China.

Podcast transcript:

Simon London: Welcome to the *McKinsey Podcast* with me, Simon London. Today, we're going to be talking about financial advice and the people who provide it: financial advisers, or as they're sometimes known, wealth managers. Wealth management is a very big business—and also a business facing a number of challenges, such as new technology, changing demographics, and tighter regulation in a lot of countries.

A little later, we're going to be getting a perspective on China. But we're going to start here in North America. For the first part of the conversation, I'm joined on the line by Jill Zucker, a McKinsey partner based in New York, and Patrick Kennedy, who's based in Toronto. Pat is chief customer officer for PriceMetrix, which provides data and analytics to the wealth-management industry. Jill and Pat, thanks very much for joining today.

Patrick Kennedy: Thanks for having us.

Jill Zucker: Our pleasure.

Simon London: Let's start by talking about technology. There's a lot of discussion in the industry around the rise of robo-advisers, which is a phrase I absolutely love, by the way. Pat, what is a robo-adviser? What's going on?

Patrick Kennedy: Robo-advisers emerged a handful of years ago when very well-funded firms were looking to introduce algorithms or digital platforms that could replace things like account opening, that could build asset allocations, understand the objectives, risk tolerance, et cetera, of the investor—and effectively build, using very low-cost investments, that which, historically, an adviser might do, such as putting together a portfolio. They have very slick interfaces and are very easy to use. There's a lot of emphasis on the graphic interface.

They emerged as the big threat to wealth management. [The thought was that] everything was going to move online. This will become the driverless car of the industry, and there will be no need for people anymore. It's interesting how that, now a few years later, the dust is settling a little bit, and we're starting to get our hands on what the real implications might be of this new technology.

“We're at a moment of inflection when financial advisers need to really provide advice, true advice, around financial planning for a household.”

Jill Zucker: Simon, it's not the first time that we've seen technology disrupt the wealth-management industry. If we think back several decades to the rise of electronic trading, discount brokers emerged from that—and they were called discount brokers at the time—and what they really did was democratize access to information.

You used to call your financial adviser for a stock quote. You wanted to know how a security was trading at a given point in the day. And that information was only available via a telephone call to an adviser. What discount brokers did was make that available in the public domain, on the Internet. And people thought, well, this is the end of financial advisers.

The financial advisers got smart pretty quickly, and they upped their game. They said, “Well, that's fine. You can get access to a stock quote. But what you don't have is access to asset allocation. You don't have your own CAPM [capital asset pricing model], and you still need advice, and you need a holistic asset allocation.” So financial advisers continued to grow their business.

What then happened with these robo-advisers that Pat's referring to, is they democratized asset allocation. We're at a moment of inflection when financial advisers need to really provide advice, true advice, around financial planning for a household, and to think about trade-offs around which products you can purchase. How do you plan for retirement in terms of your home, and should you buy or sell and move to a different location? Should you fund a child's

education, or should you fund a long-term-care policy? The advisers who can provide advice around trade-offs will continue to be very valuable.

Patrick Kennedy: I couldn't agree with Jill more. You go back 30, 40 years, and the proposition of the stockbroker—as they were called at the time—was, “I'm going to give you an idea, and I'm going to execute the trade.” Half of that proposition, almost overnight, went away.

All of a sudden, people could execute their own trades. Fast forward a few decades, Jill is absolutely right, the building of a portfolio against objectives is now—not quite a commodity, but we're headed in that direction. It can be done cheaper, it can be done better, it can be done algorithmically.

Jill Zucker: If we wonder how this is going to play out, I think it's interesting to look at other industries. If we take healthcare, for example, that [already] may be several years ahead, if not a decade ahead, in terms of its disruption—we see the rise of pop-up, urgent-care facilities in a lot of major metropolitan areas. But we certainly see the continuation of specialty medical practices on the rise. What we see from a client and a consumer perspective is a bifurcation of their needs. I go to an urgent-care facility because it's open long hours on nights and holidays and weekends, when I have a basic cold or a run-of-the-mill illness. When I have a more acute illness, there's no way I'm not going to go to a specialist. I also go with a much more informed view. Most people use a basic online search to research what they suspect may or may not be wrong with them. When we go to our doctor, we go for advice, and we go to have a conversation. We don't go for access to information in the way we may have gone even ten years ago.

Simon London: Let's talk about the size and shape of the market, the demographics. We've established that technology may change the nature of the work done by financial advisers, but there remains plenty of work to be done. So who are advisers going to be advising in the future?

Jill Zucker: Technology's clearly not the only factor in the overall economics of the industry. There are a number of forces at work. First and foremost, the nature and size of the number of clients and households seeking advice and the wealth of those households, overall.

There are some fundamental demographic transformations happening right now. The average age for both financial advisers and their clients seems to be increasing. When we look at households to start, for the first time in North American history, the oldest households are the wealthiest households.

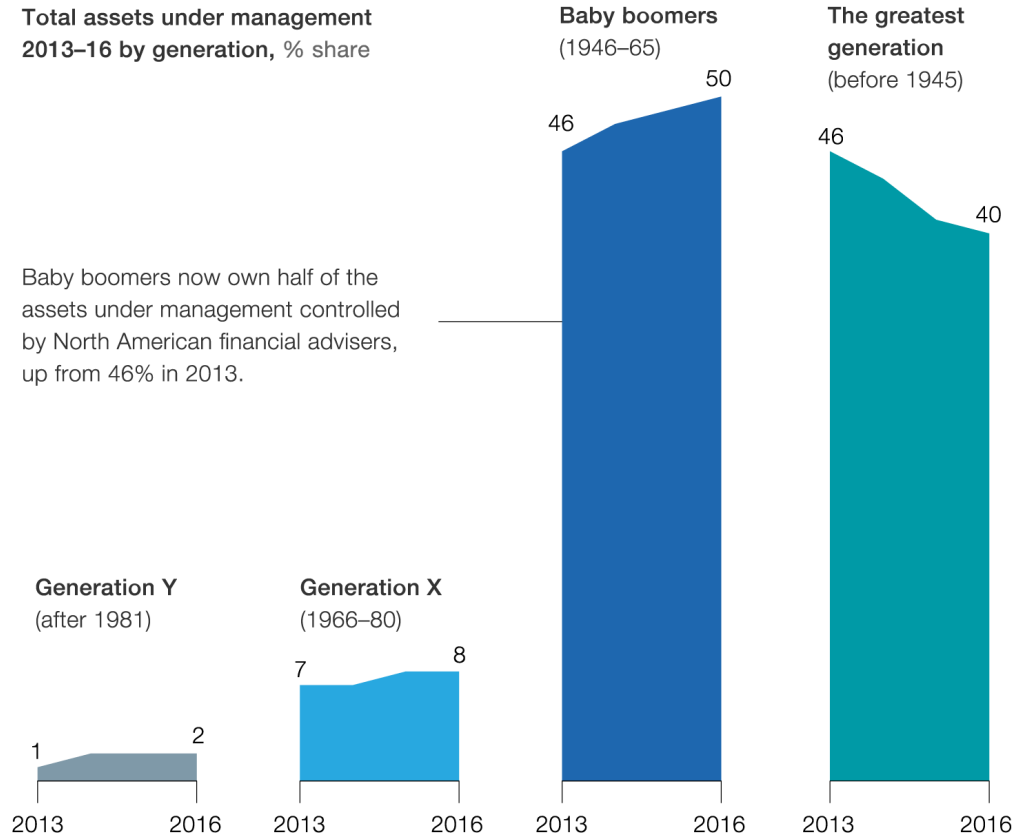
“Baby boomers ... represent about 50 percent of households in North America today, and certainly stand to be the ones with the most wealth in the coming decade.”

It was always true that older households were wealthier. But the oldest, the 75-year-old heads of households, were not always the oldest households. So we start to think about intergenerational wealth transfer in a material way. We think about how those assets are going to flow down to families. I know people talk a lot about millennials. But the reality is millennials, while they're 22 percent of the households in the US, they have about 2 percent of the assets.

Given the life span that we know is increasing for folks, it seems to reason that the intergenerational wealth transfer is going to transfer from the current generation of 75-year-old households, and older, to their baby-boom children, many of whom have at least one living parent. So the baby boomers are the next important generation to think about. They represent about 50 percent of households in North America today, and certainly stand to be the ones with the most wealth in the coming decade (Exhibit 1). There is a very different landscape on the client side than we've had in the past.

Exhibit 1

A major challenge facing wealth managers is the lack of growth in assets of **Generation Y** and **Generation X**.



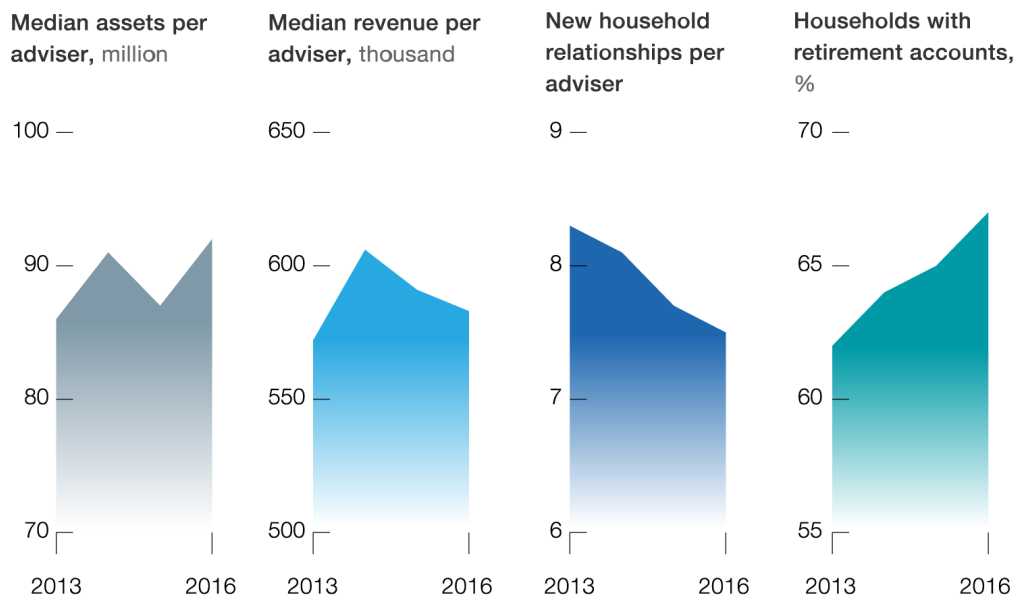
McKinsey&Company | Source: *The state of retail wealth management*, PriceMetrix, 2016

I think the other important thing, which I of course will mention, is we know that women have started to control, and have controlled, household decision making for most consumer products for some time now. But in financial services, they tended to not. What we saw is when a spouse died and the remaining partner was a woman, 60 percent of the time, the woman would move her assets to another financial firm, which means that the financial advisers were actually not serving a couple or a household, but they were serving a single individual. Pure life expectancy for women tends to be several years longer. We know that younger women are controlling spend in the household, including financial decisions. And we start to look at women as an important segment of the population, which historically just hadn't been served well by financial advisers.

Patrick Kennedy: One of the interesting things that we've observed, with respect to demographics, is there are two different types of financial adviser. There are financial advisers who have built their practice around working with a very concentrated demographic. And you can picture how that would happen. If I'm growing my book of business, interacting with clients, growing through referrals, I'm going to attract other clients that look like the ones that I have. Similar age, sometimes even similar profession. I could be quite successful at doing that. As that demographic ages and accumulates more wealth, to me it looks like I'm doing a great job, my book's growing. But then you hit a certain point and often that very concentrated demographic will turn around and start to spend the wealth that they have. In many cases, they'll start to pass it on to other generations. And suddenly, as a financial adviser, I'm not growing anymore (Exhibit 2). In fact, my business is quite a bit in jeopardy because I wasn't thinking about that next generation.

Exhibit 2

Average assets under management per adviser grew to \$92 million in 2016, but revenues per adviser decreased for a second consecutive year.



McKinsey&Company | Source: *The state of retail wealth management*, PriceMetrix, 2016

By contrast, we see certain financial advisers who are fantastic at constantly connecting with investors at the beginning of their investment journey. For us, that's not millennials quite yet. Right now, it'd be Gen X, who are, believe it or not, entering their 50s now. That's a magic age from a wealth-management standpoint because your wealth is really starting to accelerate. You're thinking about savings. College is on the mind, typically, for [those with] kids. There are a lot of big financial decisions.

But starting to think about bringing Gen X into your practice, and then thinking about technology from that standpoint. These are folks in their 40s and 50s now, who are extremely busy, who are used to technology a little bit more than the baby boomers, who are comfortable texting, for example, with their financial advisers.

Simon London: Something else I've seen in the research, Pat, is that financial advice is becoming more of a team sport, and that the most successful financial advisers are working within networks of specialism, so that they can pull on the more specialist expertise as needed. Is that right?

Patrick Kennedy: Firms encourage advisers to work in teams for a number of reasons. One is they're more likely to stay with that firm if they're part of a large team or ensemble. But that's evolved as financial advisers have learned themselves, "Wow, it's great to work as part of a team. I can actually take a vacation and not be checking my phone all the time, worried about the markets or my clients." Similarly, investors themselves—it's fascinating—they have higher levels of engagement. They have longer relationships, deeper relationships. Those investors who work with advisers who are part of a team.

Jill mentioned the emergence of importance of women investors. One of the things our research has shown specifically around teams is women investors are more likely to work with a team—in particular, a team that has women advisers on it. It's odd, but one of the most successful archetypes for a team is a husband and a wife who work as joint financial advisers. They are very successful at attracting other couples, but also individual female investors.

Simon London: We've talked about the technology. We've talked about the demographics. The third big factor here is regulation. What's going on right now in terms of how financial advice is regulated?

Jill Zucker: It's fair to say that in most developed countries, regulation exists and is likely here to stay. If I talk about the US in particular, the fiduciary rule, which essentially is holding financial advisers to a higher standard of care. Previously, there was financial advice given to clients, and it was always presumed to be in the client's best interest. But the current fiduciary rule is requiring us to vouch very specifically that the advice is in the client's best interest and is creating a suitability standard for advice. It may sound like a minor change, but it has significant implications.

The rule remains in flux, as it's being reevaluated.

Patrick Kennedy: We've seen a couple of examples ahead of the US example: something called RDR [Retail Distribution Review] in Great Britain, which went to the extent of banning commissions from products and accelerating a move to a different fee-based model there.

In Canada, where I'm based, we've just completed something called CRM2 [Client Relationship Model II], which puts on every investor's statement two things: one, their historical investment performance, and two, in dollars what they paid their financial advisers. There's definitely a trend toward transparency, helping an investor know exactly what they're paying and exactly what they're paying for. Where it'll be very interesting when you look forward, is that as much as regulations are changing, we've talked about it quite a bit today, the market itself is changing. How do you effectively regulate a robo-adviser? Is it the same rules? Is there a different set of rules?

Simon London: OK, so that gives us a great overview of the North American market. Before we jet over to China, thank you to Jill Zucker and Pat Kennedy. Thanks for being here today.

Jill Zucker: Thanks for having us.

Patrick Kennedy: My pleasure. Thanks, Simon.

Simon London: Now let's turn our attention to the wealth-management sector in China, which, as you would expect, presents a very different picture. I'm delighted to be joined on the line by Joe Ngai, who is a partner in McKinsey's Hong Kong office. Joe is the managing partner of McKinsey's offices in Greater China overall. Joe, thanks very much for taking the time to speak.

Joe Ngai: Of course.

Simon London: Talking about the North American market with Jill and Pat, a picture emerged of a mature and profitable sector—but one facing some challenges in terms of demographics, regulations, and technology. How much of that resonates from a China perspective? Maybe start with the demographics.

Joe Ngai: Unlike many parts in the world, I think China's wealth is more in the hands of the 30s-to-40s demographic. In many ways, it's a much younger demographic in terms of a wealth-management market. China is also a country of savers. But in the past few years, you have seen a country of savers turn into a country of investors. Savings, and these are mostly bank deposits, are getting turned into more investment-related products. You see the wealth-management market blossoming under such a change. That's where both—from a demographic point of view, which is a younger generation, but also from a behavior point of view, which is savers to investors—you see these two big trends happening in China.

“There have been some rapid changes in the way Chinese consumers think about their financial services.... People do have a lot of trust in, call it, Internet services or remote services.”

Simon London: So this sounds like good news for wealth managers, overall. I mean, in North America you're starting from a very profitable but quite mature industry in terms of its growth trajectory. In China, this is a market which is growing pretty fast, right?

Joe Ngai: This is certainly a market that, for a lot of traditional banks, you are seeing growth rates between 10 to 20 percent in the past couple years and that, for individual segments, you are seeing rates in the 20s.

Remember, again, a lot of these are sitting in bank-deposit accounts for a very long time. So they're essentially switching the nature of these assets. But that has brought about a bit of a revolution in the wealth-management market, and also, I would say in the demand for both products as well as advice.

Simon London: What's the role of technology from a China perspective? Because we know that Chinese e-commerce and the Chinese technology economy are quite remarkable for their dynamism. How's that playing out in the wealth-management sector?

Joe Ngai: It's definitely playing out in a big way. In the past few years, I would say that there have been some rapid changes in the way Chinese consumers think about their financial services. In particular, I think that people do have a lot of trust in, call it, Internet services or remote services.

This really started off maybe a few years ago when players, like Alibaba with Alipay, which is the PayPal equivalent in China, started to offer small depositors insurance through a money-market fund. That has now blossomed into the largest money-market fund in the world because of the ten bucks to a hundred bucks that you can put into these money-market funds.

In China, through digital, and without any kind of personal intermediary in between, you can do these things in a low-cost and direct way. In China, a phrase we use a lot is that Internet services have allowed financial services to get to the long tail of retail customers that were previously underserved or not served by financial institutions.

The second thing that has made a big difference is also around information. If you think about how people are now accessing information in China, whether it's understanding around products, or yields, or maybe different ways to invest, I would say that primarily, the information sources are from the Internet—through WeChats and a lot of the different information from either banks or other financial institutions, or even information sites. The dissemination of information is, I would say, at this stage in China, primarily through a digital interface, mostly through handheld devices and mobile devices.

Simon London: This sounds, to a layperson, like an example of what is sometimes referred to as leapfrogging, where an industry is almost being born for the first time in quite a sophisticated, Internet-enabled, technology-enabled way. Is that a way to look at it?

Joe Ngai: China went from cash into digital payments, skipping by, in some ways, the credit-card and personal-checks industry. I would say that in the wealth-management place, they've

come from savings accounts into digital wealth management. I'm not suggesting that the personal advice and the financial advisers, that they don't have a future in China. There are people who would always want to have someone to hold their hands and to explain things, particularly around more complex investment products. These are around some of the risks that will be much more difficult to explain through an entirely self-service interface.

“I don't think that wealth is a particularly good way to segment customers around either their familiarity or their trust in the digital interface.”

Simon London: Now the obvious question is how far up the wealth categories the technology-enabled platforms go. Presumably, if you are an ultrahigh-net-worth individual, you have a traditional-looking financial adviser, in fact you probably have a team of financial advisers at a private bank. But, at least as you see it in China, how far up the food chain do you think the remote robo-technology-enabled services will go?

Joe Ngai: Traditionally we think about these as wealth segments. Basically, people who are higher up in wealth, they would want personal advice. If they are kind of lower down, in their stage in wealth, then you would be more self-service. I think that it's probably more around, either, attitudes, behavior, as well as the type of products than just a wealth category. Let me give you some examples. I do think there are some people, even if they are in the much-higher-net-worth space, who are much more comfortable using a digital interface, than people in the low-wealth segment.

I don't think that wealth is a particularly good way to segment customers around either their familiarity or their trust in the digital interface. In some of the players that we have seen in China, we have seen enormous wealth-management products being transacted online with no human intervention in between. We are talking about millions of US dollars being put into different products just by a click of a button. Previously, we thought that that would never happen. But these days, the trust and the faith in some of these things with some very sophisticated and very-high-net-worth investors, they are still willing to do that because they've done it many times before. They trust the institutions and they are quite sophisticated in the usage.

I would say the differentiation is going to be more complicated. It's going to be by behavior, it's going to be by type of familiarity with technology, and it's also going to be around the type of products—for some very simple products, for very simple transactions, for example, like much safer products, much more lower-risk categories, and things that you would normally do with a lot less advice.

Simon London: That's a lovely segue into the third force that we talked about at the start. There's demographics, there's technology, and then there's regulation. How are regulators reacting to this explosion of innovation in the wealth-management sector in China?

Joe Ngai: Regulation in China is always a bit of a moving target because of how rapidly things are developing. But I think that there are a couple things in China that are worth looking out for. The first one is around the renminbi, or the currency in China.

There are a lot of capital controls in China, so, meaning that a lot of individuals would not have the opportunity to invest in global products or products that are not denominated in renminbi. This makes it so that there is a closed-off local Chinese wealth-management market, that has always been invested locally. But I think that as regulations start to open up more—for example, there are now direct connections with the Hong Kong capital markets, they're increasing what we call these QDII [qualified domestic institutional investor], which basically are foreign products that are allowed in a quota-based way, to be distributed in China.

I think that the Chinese wealth-management market is, I would say, slowly and steadily growing outside of China. As these investors start to understand the different investment opportunities that are available to them globally—I think that that is going to be something where regulation opens up—the Chinese investors getting more sophisticated, as well as, I would say, the financial institutions that are becoming more comfortable to do that.

The second point I would say is around riskier or equity-related products in China. The Chinese wealth-management market in the last couple years is mostly around fixed-income, or fixed-return products. These are products with 3 percent, 5 percent, or 6 percent, very much a fixed-income product.

The Chinese regulator is trying to make sure that a lot of the products, that previously were under some implicit guarantee by financial institutions, will no longer be a guarantee.¹ So as China's investors thought to understand that there are actually risks involved in some of these products, as they move toward a regime where there will be actual fluctuations in the underlying assets, I think that's going to be something where the Chinese wealth-management market will need to come of age a little bit.

The third one, which is something where I think we all around the world are trying to come to terms with, is around the digital distribution. Because, as we all know, while digital can be a huge enabler and make things a lot more efficient, at the same time, we need to be very conscious around how we ensure that, through the digital interface, we are getting the right products to the right customers. And throughout that, that there's no abuse and that there's no miscommunication. And how do we ensure that we use technology to enable these things to be even more effective and not get into the same situation that we got ourselves into in the last financial crisis?

Simon London: We know that the big names in wealth management in North America and Europe have ambitions in China as you would expect. Do you think we'll see some of the Chinese domestic wealth-management players expanding globally?

¹ The regulator has reacted strongly to certain innovations such as initial coin offerings while moving quickly to approve products leveraging digital. See "Cryptocurrency chaos as China cracks down on initial coin offerings," *Fortune*, September 12, 2017, fortune.com, and Jim Bulling and Michelle Chasser, "China's fintech industry growth due in part to accommodative regulations," *FinTech Law Watch*, April 14, 2016, fintechlawblog.com.

Joe Ngai: The Chinese players feel like they have a very large market on their own hands. One thing they know well is Chinese consumers and their needs. I think they'll go overseas with their customers. I think that will be the natural way for them to expand. So I will say that they will be looking overseas for product partners. They will look overseas for the different platforms where they can access international products.

I think they'll be open to either services or other advisory partnerships by where foreign players or people in different countries and platforms will have the ability and the capabilities to serve these Chinese consumers.

Simon London: Super. Well, let's leave it there. Thank you very much, Joe. I really appreciate you taking the time to speak with us today.

Joe Ngai: Great, thank you.

Simon London: And thanks to you, our listeners, for tuning into this episode of the *McKinsey Podcast*. To find out more about the changing face of wealth management and other financial services, please visit us at [McKinsey.com](https://www.mckinsey.com). □

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