The future of wealth management

Can Wealth Managers futureproof themselves and realise their true value?

JOHNSTON CARMICHAEL

An independent member firm of Moore Global Network Limited

MOORE

Introduction

Technology has adapted society over the last 30 years, however, as a sector that prepares clients for the future, the wealth management industry has been slow to change. Although Wealth Managers have embraced digital platforms to deliver part of their offering; the design of their products is essentially unchanged and historical growth in Assets Under Advice (AUA) has as much to do with Government subsidies for pensions, as opposed to offering compelling propositions to their target clients.

The needs of today's client differ greatly from before, leaving the wealth management industry on the cusp of wholesale disruption. New, digital only, online challengers have appeared who, by offering easier access to wealth management services and at a lower cost, are reshaping the client relationship in response to the changing needs of consumers.

Those seeking to secure their own and their family's future are having to change their approach, instead looking to new means to invest and save. Governmental policy, lack of confidence, increasing costs, and rising inflation leave them with a stark choice compared to the clients of Wealth Managers 60 years ago – do they save more, work longer, or die younger?

Despite some Wealth Managers starting to adapt, with Consumer Duty's spotlight on Good Consumer Outcomes, the question remains whether the industry can change quickly enough to continue to offer price and fair value to a new range of target customers?

The new consumers

Retirees

People are living longer, with a 23% increase of people aged 50-69 over the last 16 years (ELSA), equivalent to 13.3 million adults (30% of population) in England according to data from the Office for National Statistics (ONS). ONS also estimate that 10 million will survive to be within the 70-89 bracket by 2038. However, despite this age group expanding in size and significance, research and policy attention has predominantly focussed on other younger age groups.

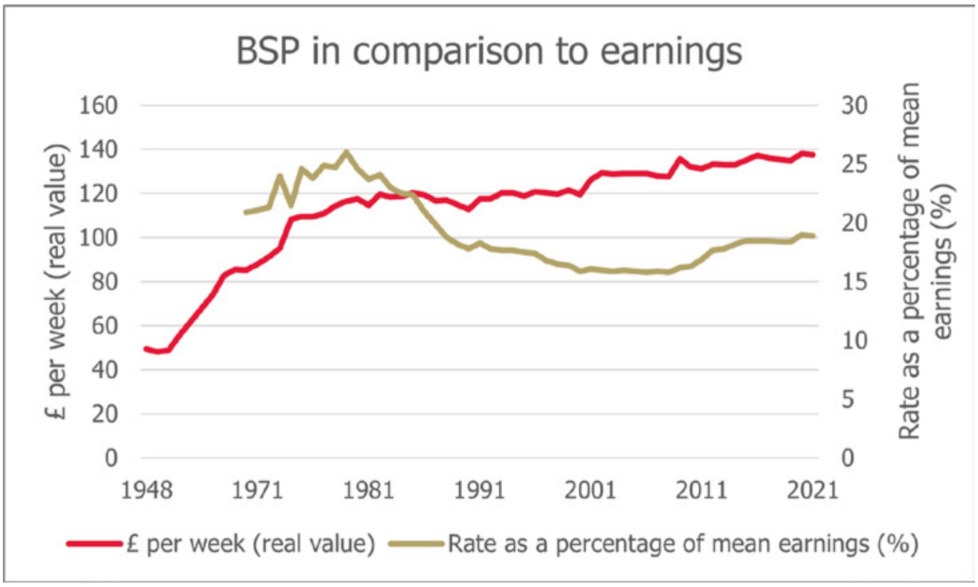
There is an increasing financial divide between richer and poorer retirees whose financial outlooks have diverged over the last 16 years. The average net wealth of the richest 20% has more than doubled, driven by rising house values, whereas in comparison the poorest 20% have seen their net wealth reduce by a third, due to an over reliance on state pensions. Wealth Managers have the opportunity to serve two distinct groups of clients within this age bracket.

1. Pensioners

Soon to be or recently retired persons, who have followed the advice they were given throughout their working life, are facing significant uncertainty as to whether the retirement that they had been sold and envisaged will materialise. All this despite being the first generation with the benefit of a near universal state pension, having always been employed and, most likely, will have been included in an occupational final salary pension scheme.

ONS data shows that in 1951 the average life expectancy at birth was 68.9, whereas comparatively in 2020 that figure stood at 80.9, representing a 12-year increase. Consequently, the length of retirement has increased too, impacting the efficacy and affordability of both state and occupational pension schemes in the future.

Since its implementation the British State Pension (BSP) has seen its generosity deteriorate in comparison to average earnings. While the response – the 'Triple Lock' pension promise (the rule stating that the state pension must rise each year in line with the highest of three possible figures - inflation, average earnings or 2.5%), has halted this decline, the BSP's real value now represents a smaller proportion when compared with average earnings.



Source: DWP Benefit Rate Statistics 2021

The future of the BSP's relative value is uncertain, the 'Triple Lock' pension promise was suspended for the 22/23 financial year by the Government due to the unusual rise in earnings (8%) after the end of lockdown. However, with inflation at a 40 year high, the BSP is set to grow by about 10% in April 2023. Despite this, the current political instability and governmental need for cuts means this increase is not guaranteed.

Employers have also become less able to fund their occupational pension schemes as their former employees are living longer. Consequently, over the last twenty years employers have attempted to lower their exposure risk and the exponential increase in cost, by taking actions such as: closing their schemes to new members of staff, prohibiting future accruals, or transitioning policy holders to other schemes.

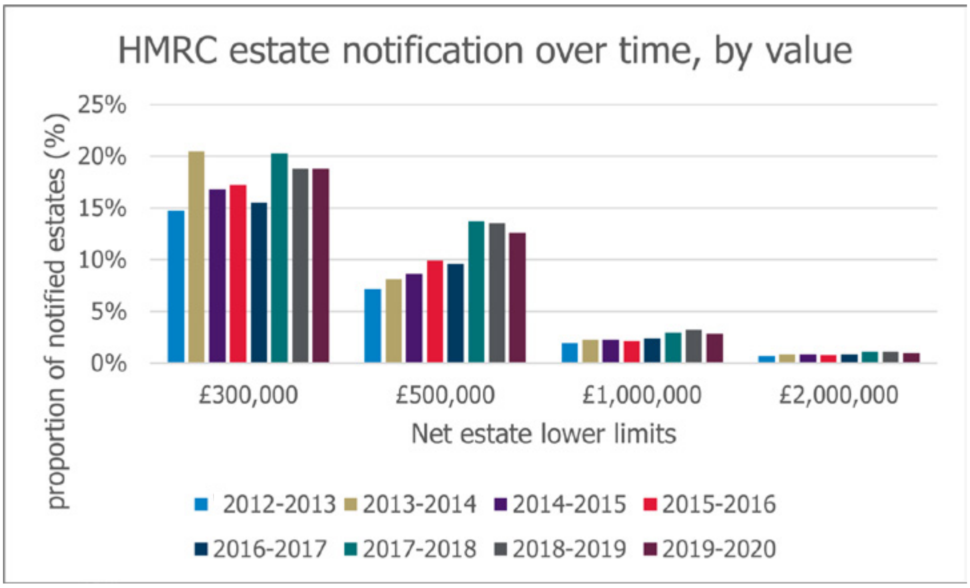
Governmental interference has left many pensioners with tough choices, either due to their reliance on a weak state pension or choosing to draw down an occupational pension and having to manage the portfolio themselves.

While Wealth Managers have served retirees, albeit indirectly by managing company pension funds, this distant, non-personal relationship is no longer sufficient for either party. Emma Byron's (Head of Retirement Solutions, Legal and General), assessment that, "carriage clock retirement is over… replaced by bespoke journeys where the retiree is in the driving seat", articulates well the changing role the Wealth Manager needs to have with this target customer group.

The synergy is clear, most retirees lack the expertise that Wealth Managers possess. A manager's focus should change, not only to help prepare individuals for retirement during their working lives but also offering ongoing management of a portfolio during retirement.

2. Decumulators

Within the retiree population, we see a second type of retiree, one that may be less concerned in eking out their pension and instead requiring expert advice to help them legally reduce their exposure to inheritance tax. This is, in the main, because of increased estate value, driven by property values which have increased over time.



Source: HMRC, July 2022

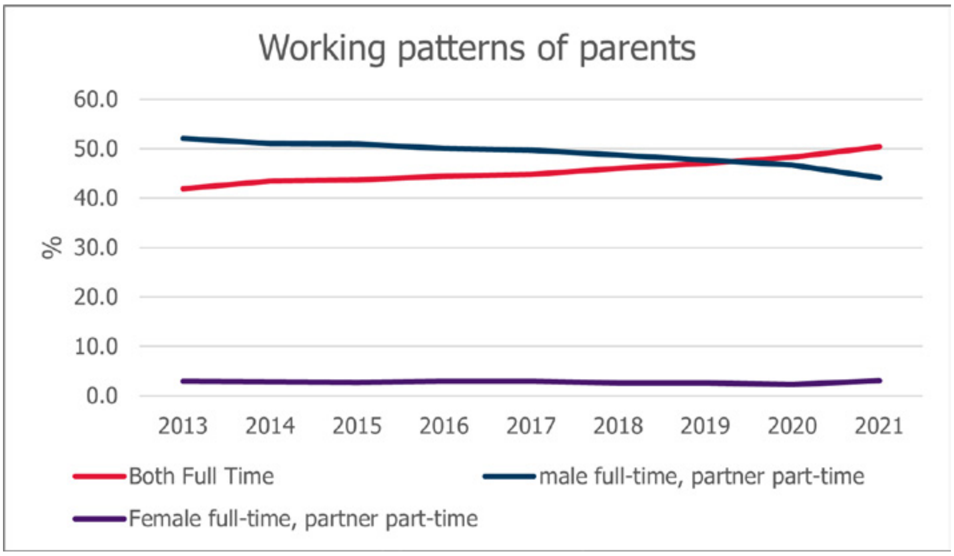
Land Registry data shows a 71% increase in average UK house prices over ten years, from £167,854 in April 2012 to £286,397 in June 2022. Despite this, since 2009 the inheritance tax threshold has stayed constant and is now fixed until April 2026. Therefore, in the last decade, due to the rise in estate value relative to the threshold, there has been a year-on-year increase in the proportion of total estates notified to HMRC and that are liable for inheritance tax.

Consequently, the decumulator's need is the antithesis of a Wealth Manager's normal; they need advice to decrease wealth and the specialist knowledge on how to do this legally and tax efficiently. It also represents an opportunity for Wealth Managers to access new clients in the form of the decumulator's children or grandchildren.

Working families

Consumers who grew up and entered the job market during, or just after, the 2008 financial crash have faced a decade of difficult financial circumstances - student debt, lower pay caused by high competition for jobs, increasing house price inflation and tighter regulation on borrowing. However, they now face new challenges.

The Labour Force survey on working patterns shows that for the first time, it is most common for both parents to work full time because of increased costs of food, mortgages and energy. Despite this, they have started to build assets and are possibly about to inherit assets from their more elderly relatives.



Source: ONS, Labour Force

After the Bank of England's (BoE) toughest tightening cycle since 1997, the base rate reached 2.25% in September 2022 and will likely increase further with inflation continuing to sit above their 2% target. As a result, working families' monthly disposable income will continue to shrink, driven by the cost of food, energy, and the Money Savings Expert's projected 42% increase over 2022 in average monthly mortgage costs.

Wealth Managers have not customarily helped people at this stage of life as their thresholds have tended to favour those who have already accumulated higher levels of assets. In the past, members of working families might have had occupational pension schemes supplemented by their state pension and help from other family members during retirement. However, with the slow decline in the real value of pensions, this group are looking for better ways to prepare for the future, whether for their own retirement or the future of their children.

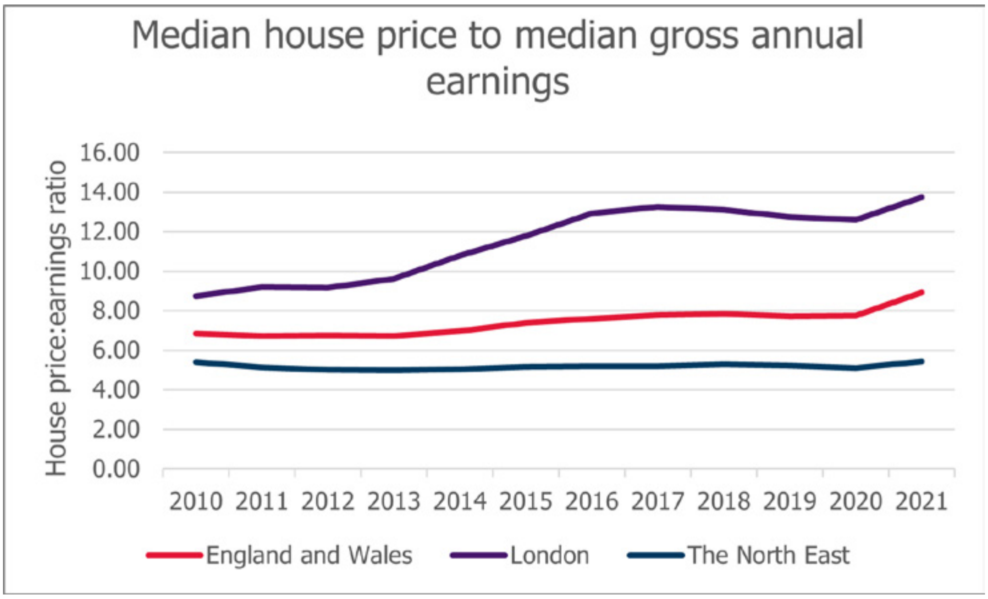
These clients are a challenge to a Wealth Manager's traditional approach with many suspicious of the financial sector stemming from financial mismanagement which resulted in the 2008 crash. The result is an increased concern with the makeup of their investments and desire to select, and in some instances manage portfolios themselves.

Younger professionals

Younger professionals, recent school or university leavers, entering full time work for the first time are challenged by the recent period of low interest rates and the corresponding lack of savings growth.

ONS data shows that due to property price inflation and slow wage increase, the ratio between house prices and earnings in England and Wales has grown. As with working families, this property price inflation is making home ownership a significant financial undertaking and we see young professionals taking longer to get on the property ladder.

Rightmove's research suggests the average first-time buyer now requires a deposit of £74,402. This is more than double the figure from ten years ago! In comparison, wages have only increased by 35% over the same period. This stark contrast has left housing less affordable, with many younger professionals delaying the decision to enter the property market and instead renting for a longer period of time.



Source: ONS

According to Rightmove, monthly rental costs have risen 40% compared to only an 11% rise in monthly mortgage payments over a ten-year period. This increase in private rental costs has been driven by excess demand in the rental market and the rising cost of buy-to-let mortgages, a rise that has gradually eaten into younger professionals' capacity to save for a mortgage deposit themselves. Therefore, as a group they have increasingly turned to the 'Bank of Mum and Dad' to achieve and put down these bigger deposits, although this clearly is not an option for all.

A 2019 Canada Life survey evaluated that due to the increased cost of insurance and regulation, the previous five years has seen a 50% reduction in the number of firms that can afford to take on new clients with assets totalling less than £100,000. As a result, the wealth management profession's concern should be that younger professionals are becoming part of what Canada Life have dubbed 'the lost generation of clients'.

Equally, Eric Borremans' (Head of ESG at Pictet) commentary that, 'the next generation, have grown up discussing environmental issues, which wasn't the case for their parents', represents a significant change in expectation as clients get younger. No longer are returns the sole marker for success, with social and environmental impact now playing an equally significant role.

With home ownership, almost out of reach without the 'Bank of Mum and Dad', attitudes to savings and investments have changed. Younger professionals are depositing smaller amounts more often, focused on funding shorter term moments or memories, and are more likely to reference the impact of their investments as a sign of success compared with previous generations.

The opportunity

Wealth Managers hold their future in their own hands and by acting now, they will be able to shape the sector, and firms within it, for the next 50 years.

Low-cost, pseudo-advisors, who service new clients principally with AI led technology, will not eliminate traditional wealth management practices. Instead, they have shown that in order for Wealth Managers to keep the position they hold in the market, they need to redesign their offerings to meet new needs while also re-imagining how they communicate and build relationships with clients.

Companies have started to change, intent on either adding value propositions to fast-growing customer segments (e.g., UBS and AJ Bell), adapting and aligning their communication channels with the needs of their new target client (e.g., Monzo and Revolut), or viewing their investments through an Environmental, Social and Governance (ESG) lens (e.g., Abrdn and HSBC UK). However, these all respond to specific problems rather than viewing the customer's journey as a whole.

Wealth managers should consider the whole journey of a consumer to create a lasting effect, with specific consideration in 3 key areas:

1. How much does it cost?

Currently, for prospective clients, cost is the initial differentiator between approaches to wealth management.

The appearance of non-traditional FinTech competitors, increased regulatory costs, and higher wages have left traditional in-person wealth management firms uncompetitive on price alone.

Despite the immediate lure for companies to reduce costs by using cheaper digital solutions, cost optimisation rather than cost reduction will support long term economic viability for wealth management. Firms who use technology to process simple, time heavy tasks, and outsource non-core, low value services will be able to cut costs and allow Wealth Managers to increase their value by forming lasting client relationships.

2. Do they offer the product I want?

Wealth management is no longer a linear journey with a singular end goal in mind, but rather a unique one interspersed with differing life events and desired outcomes.

As a result, the old metrics used to segment clients (income, investable assets, and risk profile) do not sufficiently serve Wealth Managers or define today's target clients. Instead, there is a need for a personalised wealth approach, focussed on the client's individual circumstances, financial sophistication, and goals.

Equally, increased emotional attachment driven by greater insecurity in their future, lack of trust in the industry, and greater financial literacy has created a desire by more consumers to have a larger involvement in their own investments.

Technology provides a solution to clients and managers alike. The use of a digital platform to collect information and increase the regularity of less formal meetings can also improve two-way communication. Greater client engagement and enhanced client understanding result in more suitable client propositions and should improve client loyalty.

3. Is the investment 'good'?

ESG programs and investments have garnered significant interest from governments, the public and the financial sector.

In 2016, when The Paris Agreement set ambitious environmental targets, it drove a pointed change in governmental policy. As a response, governments have, in the main, enhanced spending on climate friendly projects and conversely increased taxation and regulation on 'harmful' schemes.

The key pillar to the inter-governmental climate emphasis is a significant change to global energy mix, only a small proportion of which is currently renewable and will require vast developments to achieve ambitious governmental targets. This creates great investment potential in companies that can facilitate the necessary change.

After a decade of slow wage growth, and COVID-19 recalibrating the workforce's attitude to work-life balance, consumer preferences are driving change in the way in which companies operate. Consumers are making purchasing decisions with sustainability in mind and are increasingly scrutinising governments and corporations on social issues.

Top-down governmental pressure and bottom-up consumer preferences for change and not just returns, have pressured the financial sector to adapt. This societal and governmental focus has created significant opportunity for Wealth Managers, particularly those with portfolios with ESG components.

Conclusion

The consumer groups described in this article are not finite, and, in each segment, there are sub-groups that will require Wealth Managers to tailor their response to client's specific needs. Despite having similar preferences in relation to customer experience (the hygiene factors), clients are likely to have differing reasons for seeking advice, varying amounts to invest, varying needs, goals, and communication preferences, including type and frequency of contact.

Technology can clearly assist Wealth Managers service a broader range of clients with tailored wealth management services whilst simultaneously optimising their cost of delivery.

Given the importance of the topic to consumers, and the wealth management options presented earlier in the article (save more, work longer, or die younger!), wealth management remains a vital service for consumers. However, Wealth Managers need to offer propositions that allow earlier, easier, and cheaper access so consumers can start to save smaller amounts earlier in life to build their nest eggs and generate returns that create an attractive endowment effect.

Other sectors have shown the potential for consumer led disruption enabled by technology. Wealth Managers need to invent their future refocusing on their clients by redesigning their propositions and ways of working to secure both their clients' and their own futures!

Get in touch

If you would like to talk more about this article, or learn about our target operating model and cost optimisation methodologies, then please do get in touch.

Ewen Fleming
Partner and Head of Financial Services

M: 07733 236559

E: Ewen.Fleming@jcca.co.uk

Tim Swinson
Consulting Manager

M: 07825004479

E: Tim.Swinson@jcca.org.uk

JOHNSTON CARMICHAEL

Where sharp minds meet

Aberdeen
01224 212222

Dundee
01382 411790

Edinburgh
0131 220 2203

Elgin
01343 547492

Forfar
01307 465565

Fraserburgh
01346 518165

Glasgow
0141 222 5800

Huntly
01466 794148

Inverness
01463 796200

Inverurie
01467 621475

London
0203 7144 350

Perth
01738 634001

Stirling
01786 459900

jcca.co.uk