OLIVER WYMAN

Financial Services

RETAIL BANKS & THE IRA ROLLOVER OPPORTUNITY

THE ROAD TO WEALTH (MANAGEMENT)

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INTRODUCTION

Banks have long sought a bigger share of the wealth management market, and the enviable stream of capital-efficient fee income that it entails. With banks' traditional lending, deposit and transactions businesses squeezed by post-crisis regulations and low interest rates, their enthusiasm for wealth management is only growing.

The challenge for banks has always been how to break the stranglehold that more established wealth management business models hold on the market, driven both by brand loyalty and a better ability to advise clients with complex needs. This Oliver Wyman point-of-view looks at one specific "break-through" opportunity for banks: namely, making themselves the preferred destination for customers rolling over their defined contribution plans into an IRA. This is an approachable opportunity even for banks without large wealth management functions because it is scalable without having to rely on a large highly paid staff. We argue that this is one of the best ways for a bank to build scale in, or even start, its wealth management business.

The market for rollovers today is dominated by the leading defined contribution plan administrators, such as Fidelity and Vanguard. These firms enjoy well-established retirement brands and, given their incumbent positions as the plan administrators, provide a logical destination for a rollover. While these are genuine competitive advantages, they are not insuperable. As we explain, banks possess significant strategic assets they could bring to bear in this fight. As the providers of core banking products, they too possess well-established brands and incumbent relationships with the target audience. And the information that banks naturally gather about their customers gives them an advantage in identifying when customers have changed jobs or retired, the events which traditionally trigger a rollover into an IRA, and a fuller view of the customer's overall financial picture.

If banks can learn to use this information to target customers, offer the investment choices they are looking for and provide the hassle-free rollover that they desire, then IRAs can provide a launching pad into the much larger wealth management business.

MARKET CONTEXT

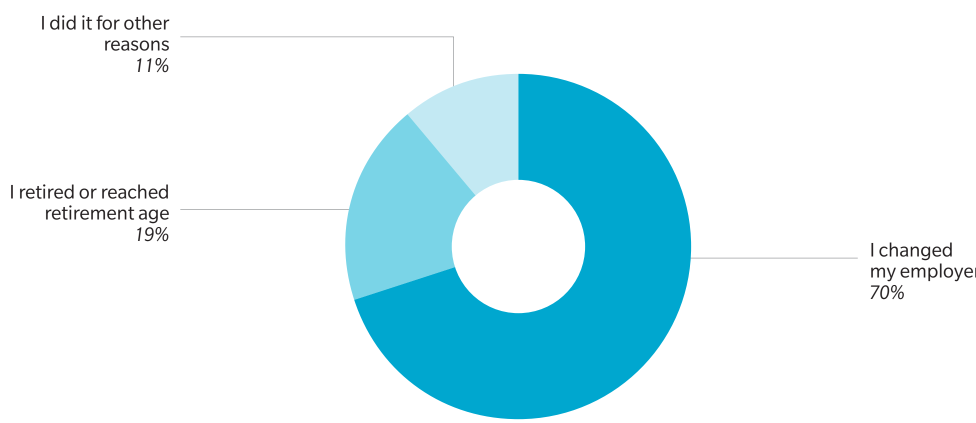
Individual Retirement Accounts (IRAs) were created in 1974 by the Employee Retirement Income Security Act (ERISA). Like the 401(k), or other defined contribution plans, the IRA is a long-term savings product to which the majority of contributions are tax-exempt, and where account balances enjoy tax-deferred or tax-free growth. Unlike the 401(k), however, an IRA is set up by individuals rather than by their employers.

Under the provisions of ERISA, transfers of funds from employer sponsored 401(k) retirement plans into IRAs (rollovers) are tax and penalty-free. IRAs also offer most individuals a much broader range of choices, both in terms of investment vehicles and providers, than do traditional employer-sponsored retirement plans. These factors have made IRAs a primary destination for employees rolling over their defined contribution accounts when changing jobs or retiring.

IRAs already constitute a large pool of assets – about $5.7 TN according to ICI estimates (see Exhibit 2) – and, as of 2013, 46 million households or ~40% of all US households already hold them. They are also growing rapidly, fueled in part by rollovers from employer-sponsored plans[1]. Between 1996 and 2008, IRA balances grew at an annual rate of 7.5%, with rollovers peaking at $316.6 BN in 2007. 27% of traditional IRA-owning households rolled over within the last 2 years[2]. The firms that provide and manage IRAs earn fees largely from trading commissions and asset management. Collectively, we estimate that IRA balances constitute a $30 BN revenue pool.

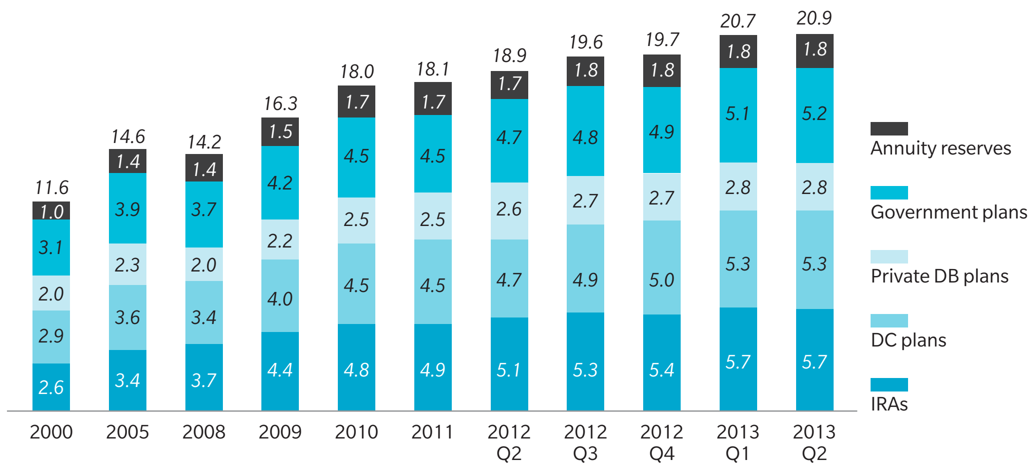
1 ICI Research Perspective: Vol. 19, No. 11, November 2013
2 ICI Research Perspective: Vol. 18, No. 8, December 2012

Exhibit 1: Why did you rollover your 401(k) account into an IRA?



Source: Oliver Wyman Retirement Insights 2013

Exhibit 2: Growth in retirement market ($TN)

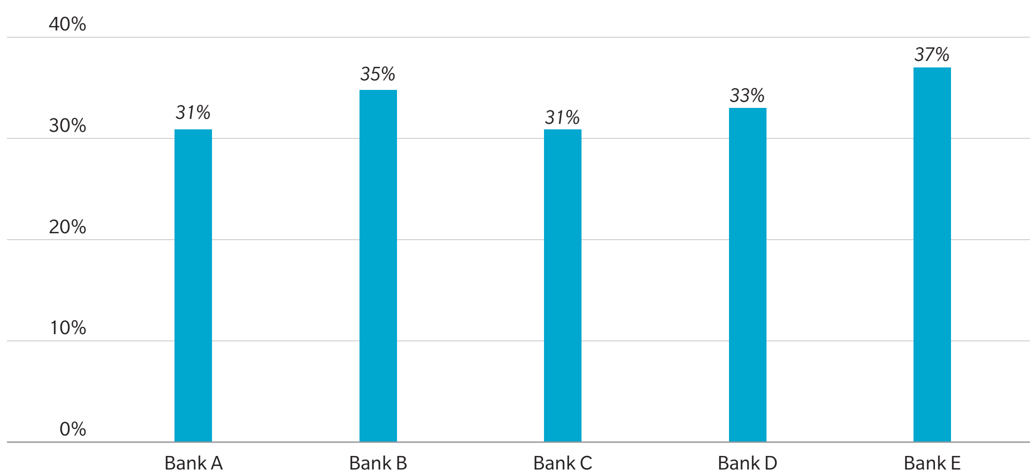


Source: ICI Research Report: Defined Contribution Plan Participants' Activities, First Three Quarters of 2013, February 2014

COMPETITIVE LANDSCAPE

Banks have long sought a larger share of the wealth management market, and the enviable stream of capital-efficient fee income that it entails. With banks' traditional lending, deposit and transactions businesses squeezed by post-crisis regulations and interest rates, their enthusiasm for wealth management is only growing. IRA Rollovers are an appealing strategic focus given the frequency with which they occur and the amount of money in motion. To that end, nearly all of the large national and regional banks already offer IRAs. But recent Oliver Wyman primary research shows that 30-40% of their customers are unaware of this offering (see Exhibit 3).

Exhibit 3: Percent of customers who do not know that their primary bank offers an IRA (when it does offer the product)



Source: Oliver Wyman Retirement Insights 2013

The major 401(k) plan administrators are currently winning the fight by a wide margin. According to our research, Fidelity and Vanguard, the two best-known plan administrators that offer IRAs as well, currently capture more than 40% of all rollovers. Brokerages such as Merrill Lynch and Morgan Stanley also do well on this dimension. The dominance of these two business models is easily explained. Plan administrators have well-established retirement brands and, as the incumbent providers of the 401(k), appear to most customers as the most straightforward rollover destination. Brokerages have large advisor forces, the widest range of investment options and existing relationships with the wealthiest rollover candidates.

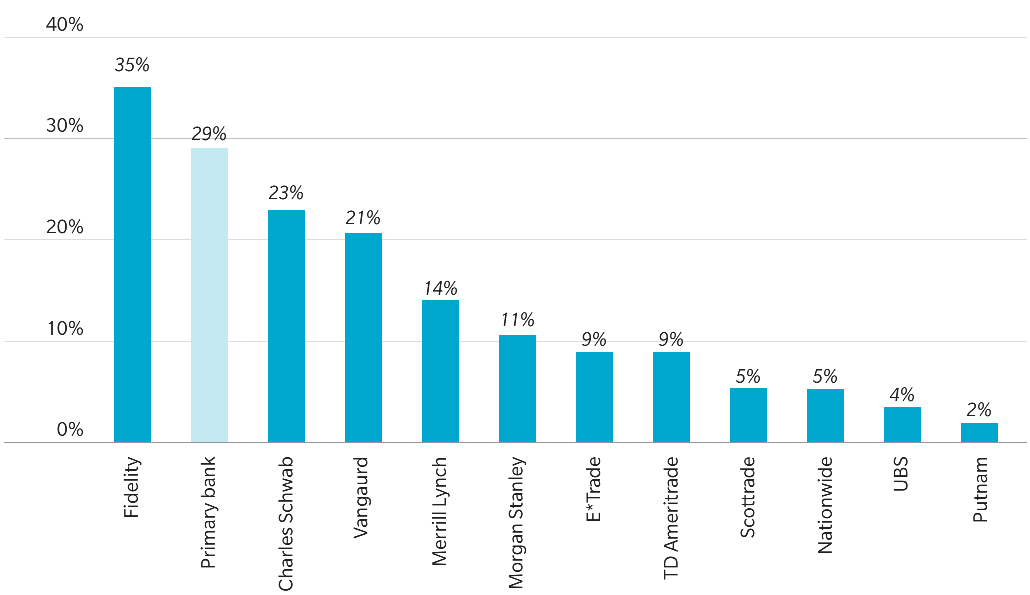
HOW BANKS CAN COMPETE

The lead plan administrators and brokerages enjoy in the IRA rollover market may seem unassailable, but it is not. In recent research conducted by Oliver Wyman, potential IRA customers ranked their primary checking account bank second only to Fidelity as a potential rollover destination (see Exhibit 4).

We believe the recipe for converting consideration to a successful rollover strategy consists of three key elements, outlined below and then explained in detail.

1. Customer focus: "Force concentrate" on the population where the bank possess the strongest incumbency advantage
2. The offer: Construct the rollover value proposition around a "no-hassle" process and a broad suite of investment choices
3. The marketing strategy: Leverage data from the customer's checking account to identify when rollover opportunities arise before brokerages or plan administrators can see them, and utilize the full breadth of touch-points to drive up awareness of the offer

Exhibit 4: If you had to roll over your 401(k) today into an IRA, which financial institutions would you seriously consider rolling it over to?



Source: Oliver Wyman Retirement Insights 2013

1. TARGET CUSTOMER SEGMENTS

A typical bank can identify at least three pools of customers that it can target for IRA rollovers. These include:

- Current banking customers, including those that use the bank as their primary checking account
- Employees of commercial customers
- Non-customers in footprint, who are aware of the bank's brand and presence

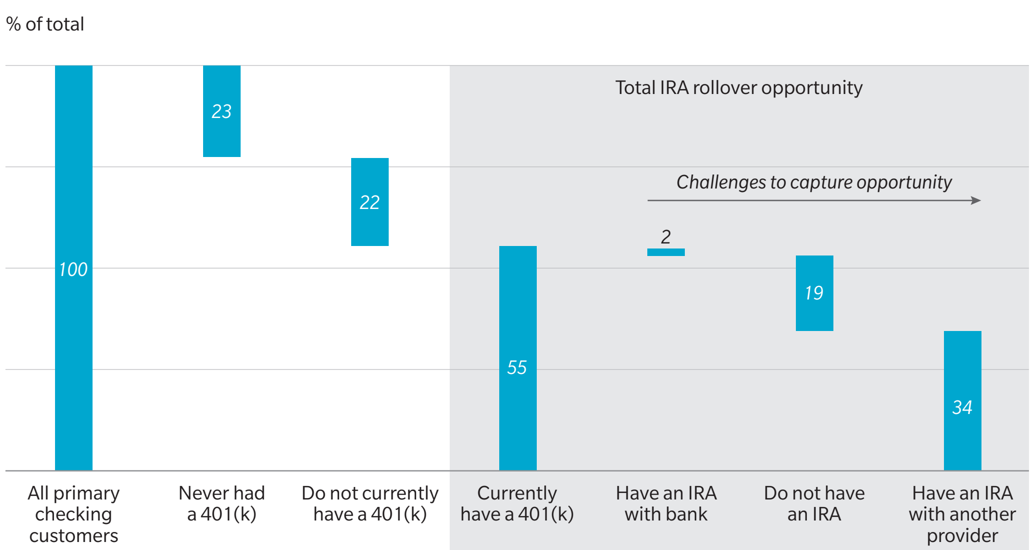
Among these pools, banks have the strongest relationships with primary checking customers, i.e. those that use them as their primary means of performing day-to-day transactions and frequently have salaries direct deposited into the account. These customers tend to stay loyal and have frequent ongoing interactions with the bank. We believe that this is the pool of customers that banks should focus on first.

Not all these customers will have 401(k) accounts. In recent research for a regional bank, we determined that only 55% of their primary checking customers had a 401(k) account. Among these, those that do not currently have an IRA are easier to capture than those that already do. For this particular bank, we estimated that 19% of their primary checking customers fell in this category (see Exhibit 5).

Penetration rates of 2-3% are typical for banks that have not made a concerted push in this space. Increasing this to 10% is a $100+MM incremental revenue opportunity for a typical regional bank. And given product ownership rates and the advantages banks enjoy, this is quite achievable.

DDA data on income and balances can also be used to identify customers who have high-balance 401(k) accounts. Targeting these customers will yield more profitable outcomes in terms of higher trading commissions and asset management fees, given they're strongly correlated with balances.

Exhibit 5: IRA Rollover opportunity among primary checking customers



Source: Oliver Wyman Retirement Insights 2013

2. THE OFFER

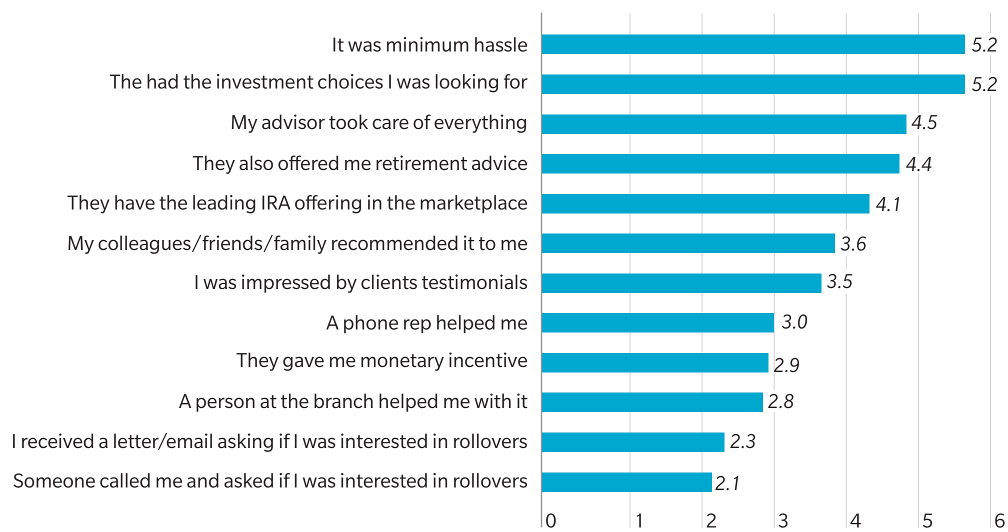
In the past few years, a "cash reward" arms race of sorts has broken out among plan administrators and online brokerages competing for IRA rollovers. Schwab, TDAmeritrade, E*TRADE and many others offer up to $600 in cash to prospective clients. This bounty is substantially higher than what banks have traditionally proven willing to pay for new accounts, and would spell doom but for one thing: it doesn't seem to matter much to customers. Recent Oliver Wyman research suggests that customers place much higher emphasis on minimizing the hassles associated with the switching process and getting access to a wide range of investment options (see Exhibit 6).

Reducing the hassles associated with the rollover process can also help banks overcome any possible disadvantages of not having a robust advice offering. The rollover can be the beginning of a relationship that evolves into advice, with the early wins associated with the no-frills rollover strategy being used to fund the development of a more holistic, advice-based offering.

There are many elements that go into making the rollover process low-hassle. One, banks must make the process quick, let customers know in advance how long it will take and provide regular updates; the pain for customers is usually not the time but the uncertainty. Two, they should reduce the pain associated with reconstructing an investment portfolio. They should find out the portfolio composition in advance and try to replicate that; at the very least, they should be able to offer an alternative portfolio that is materially equivalent in its risk/return profile. Three, they should try and reduce paperwork, e.g. by enabling online submissions and letting people provide images of documents instead of only offering older, more outdated methods.

Exhibit 6: Why did you select your current IRA provider to rollover your 401(k) account?

AVERAGE SCORE FOR CUSTOMERS WHO HAVE DONE AT LEAST ONE ROLLOVER*



* Each respondent was asked to rank all these reasons on a 7-point scale, where 1 was "Not important at all" and 7 was "Extremely important"

Source: Oliver Wyman Retirement Insights 2013

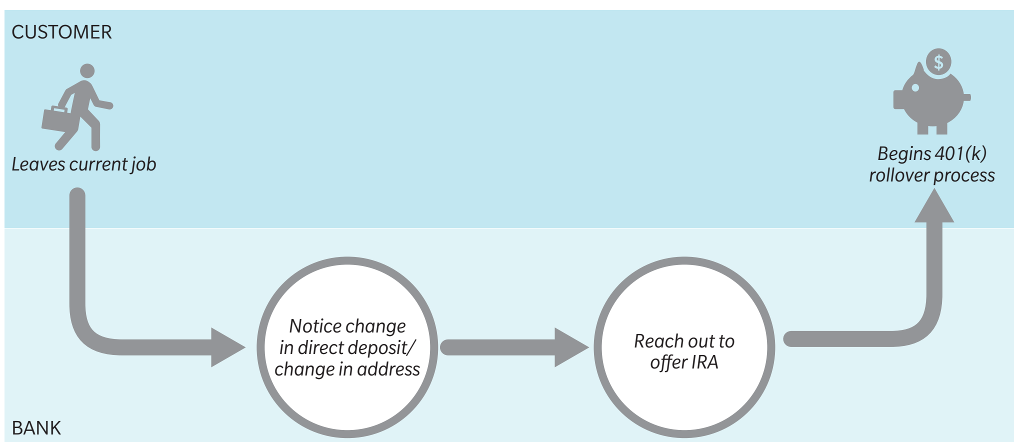
3. THE MARKETING STRATEGY

There are two competitive advantages that banks possess, which can drive effective marketing of the rollover offer.

First, by monitoring a person's checking account, a bank can tell whether a person has changed jobs by observing a change in the direct deposit source. The bank can also glean if someone has retired by combining the age of the customer with a total stop in direct deposits. A change in address may also indicate a change in job or retirement. Banks can use such information to trigger direct marketing to target customers (see Exhibit 7), which is something that brokerages cannot do.

Second, banks have a significant distribution and interaction advantage with their primary checking customers. Banks can utilize the various channels their customers use to build awareness of their offering and to solicit prospects. Plan administrators typically have minimal branch networks and few occasions on which to interact with their customers. Once the bank has reached out to a prospect based on a trigger, they can use the branch to consummate the rollover transaction. The initial outreach can also be delivered via the channel preferred by the customer – online, mobile, or the branch itself.

Exhibit 7: Illustrative IRA rollover direct marketing process



CONCLUSION

Building a wealth management business is a daunting prospect for most retail banks. Not only does it require a costly extension of most banks' infrastructure, but it also requires expensive new advisory staff who often find it difficult to fit into the culture of a retail bank. The current model whereby certain products, such as insurance and mutual funds, are sold out of branches avoids these problems but fails to create a compelling reason for customers to use the bank as their primary wealth manager. When it comes to wealth management, many banks are stuck at the starting line – unwilling to make the investment required for the full retail brokerage-style offering and unable to see any other way to move forward.

IRA rollovers are a good way to get started because the product and platform can be outsourced so that the bank plays only the primary roles of advisor and distributor. The IRA rollover discussion can also be used as an entrée for a broader retirement-focused conversation down the line, potentially leading to an overhaul of the customer's finances and consolidation of assets into the bank. Income from the IRA assets can then be used to fund the development of a broader wealth management offering.

For many customers, rolling a 401(k) into an IRA often marks a "new beginning". If banks can capture a bigger share of this business, it may also mark a new beginning for their ambitions in wealth management.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

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