EXECUTIVE INSIGHTS

UK Wealth Management: Spotlight on Value Creation

Key takeaways

01

UK wealth management is a trillion-pound market, with c.£2 trillion in personal liquid investable financial assets held by UK households and £1.9 trillion residing in defined benefit pension liabilities.

02

The industry structure operates across three principal layers: client management, investment platforms and investment vehicles.

03

Despite Covid-19, the market has continued to grow due to favourable asset growth trends, including market growth/ asset appreciation, regular savings and top-ups, and auto-enrolment and defined benefit pension transfers since 2017.

04

In the past decade, wealth management has been subject to significant change, with regulation, Covid-19 and technology shaping new business models, enabling superior client propositions and larger profit pools.

There are very few trillion-pound markets in the UK, but wealth management is one of them L.E.K. Consulting estimates that there is c.£2 trillion in personal liquid investable financial assets held by UK households, with a further £1.9 trillion residing in defined benefit (DB) pension liabilities.

Over the past few years, the wealth management market has been subject to significant change, as regulation, Covid-19 and technology shaped business models, enabling superior client propositions and larger profit pools. In this Executive Insights, L.E.K. examines the UK wealth management market and explains why it presents a fertile ground for growth and value creation for industry operators and investors.

Complex industry structure

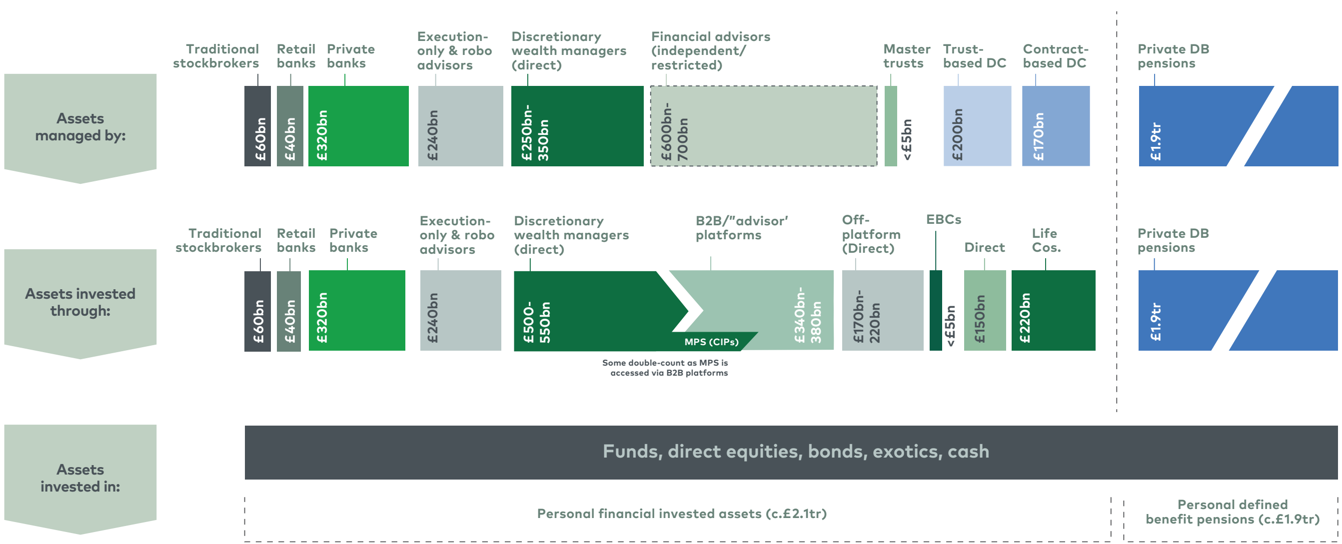
The wealth management industry has traditionally operated across three principal functional layers.

1. The **client management** layer is key for a number of crucial value-adding activities, including client relationship management, proposition development, client risk assessment and portfolio design. This layer includes the spectrum of wealth managers — financial advisors, discretionary fund managers and private banks — as well as self-managed, do-it-yourself investment platforms. Approximately £1.2 trillion of client assets are managed by the advisory community (see Figure 1, Size of UK Wealth Management Industry). Together, these form the bulk of the wealth for mass affluent and high net worth individuals. Large financial institutions, such as banks and insurance companies, hold fringe positions. Some have explored rebuilding their presence (e.g. Lloyds) but few have succeeded so far.

2. Client assets are invested through the **investment platforms** layer (see Figure 1, Size of UK Wealth Management Industry), which provides the backbone of the industry. Businesses in this layer range from third-party B2B advisor investment platforms to proprietary platforms built in-house or leveraging technology capabilities from providers such as FNZ, SEI and Pershing. A range of supporting businesses also operates in this layer, including self-invested personal pension (SIPP) administration providers. The B2B platform market has been a significant beneficiary of asset migration to technology platforms in recent years, but this is now tailing off.

Figure 1
The financial advice segment is worth c.£600-700m in AuM and is the largest of the overall c.£2tn UK wealth management market

Estimated distribution of UK personal financial investment assets (2020)



Source: L.E.K. research and analysis

3. The third layer is the **investment vehicles** layer (see Figure 1, Size of UK Wealth Management Industry) — this is the realm of the asset management industry, where changes in the client management and investment platforms layers have created disruption amongst retail-focused managers.

Growth drivers

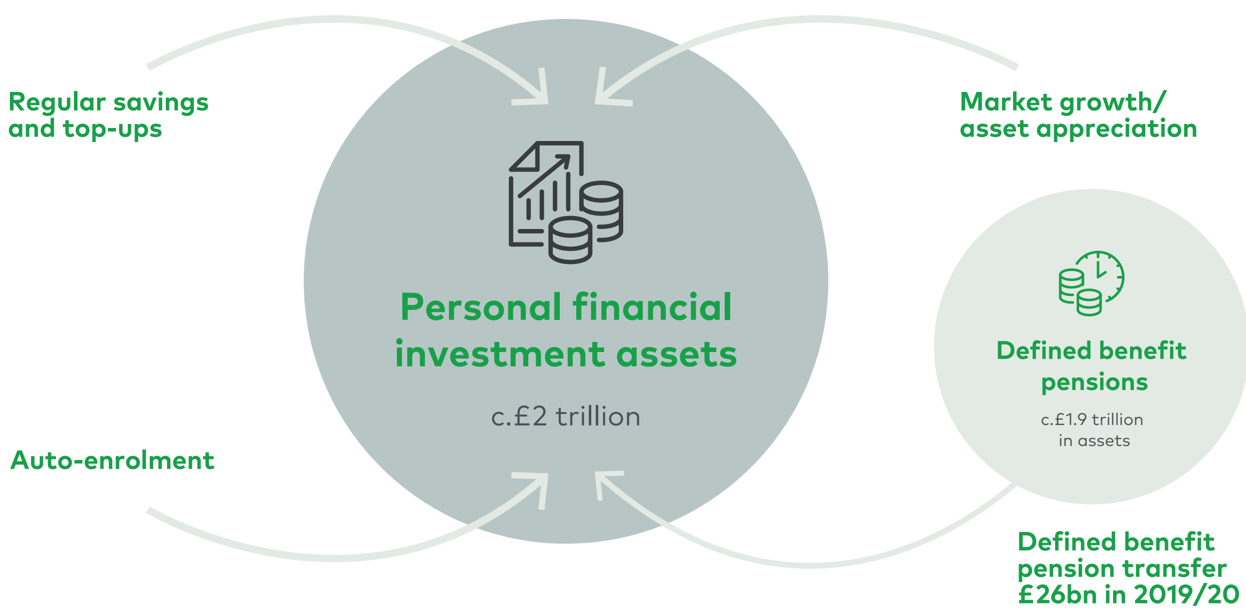
The number and wealth of mass affluent and high net worth individuals in the UK have grown consistently, with only minor blips during past recessions (including 2020). House price appreciation, low debt rates, record business start-ups and a favourable economy have all supported wealth creation and appreciation. In addition, the industry continues to benefit from a number of favourable asset growth trends (see Figure 2).

Pressure on public finances created by an ageing population is well documented, with successive governments using policy levers to shift responsibility for providing retirement income from the state to the individual. Building up savings and investments is increasingly a top of mind 'issue for many in the workforce today.

Pensions reform, enacted in 2014, has provided individuals with new freedoms to access and manage their pension assets. In particular, individuals may transfer their DB pensions into other pension wrappers (e.g. SIPPs), which are serviceable by wealth managers. While transfers of this kind have reduced after an initial burst of activity, DB transfers of £26 billion entered the wealth management industry in 2019. There is still significant headroom when one considers the substantial stock of DB liabilities outstanding — c.£1.9 trillion in 2020.

Compulsory pension auto-enrolment has created a new vehicle for pension asset accumulation in the industry. Since April 2019, employees and employers have been required to contribute 8% of salary p.a., which in 10 years could accumulate into significant savings for many people.

Figure 2
Asset growth trends

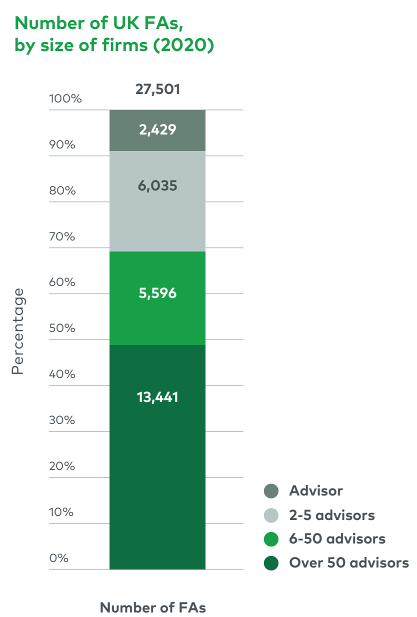


Source: L.E.K. research and analysis

Financial advisor capability in short supply

In an environment where financial planning and investments have become increasingly complex, the need for advice has never been more pronounced. Our publication **Four Steps to Developing a Winning Wealth Management Proposition for an Ageing Population** highlighted that over 80% of UK consumers felt they needed financial advice, but only 20% sought it. While there is much noise surrounding 'robo-advisors', the concept has failed to achieve scale, as human-to-human interactions are still highly valued by young and old consumers alike. After a period of regulatory change, the industry's numbers have recovered to c.28,000 advisors, but advisors are still in short supply because our estimation indicates that they can only service two to three million clients on an ongoing basis. Consolidation has in part allowed the industry to create value through leveraging centralised functions and capabilities — i.e. doing more with less. Yet despite the activity of recent years, the Financial Advisor industry remains relatively fragmented, and there is still significant headroom to further roll up business models and strategies (see Figure 3).

Figure 3
Financial advisor landscape



Category	No. of firms	Average FAs per firm	Characterisation of segment
Longer tail of single advisors	2,429	1	One-man-band advisors
2-5 advisors	2,152	3	Small partnerships and individuals, serving a largely local book of clients
6-50 advisors	508	11	Emerging crop of consolidators/ mid-sized FAs Varying degree of regional/ national footprints
50+ advisors	48	280	Large advisory firms with high shares, e.g. established consolidators, national majors, advice arms of major Financial Services companies

Source: Financial Times

Three disruptive forces — regulation, technology and private capital

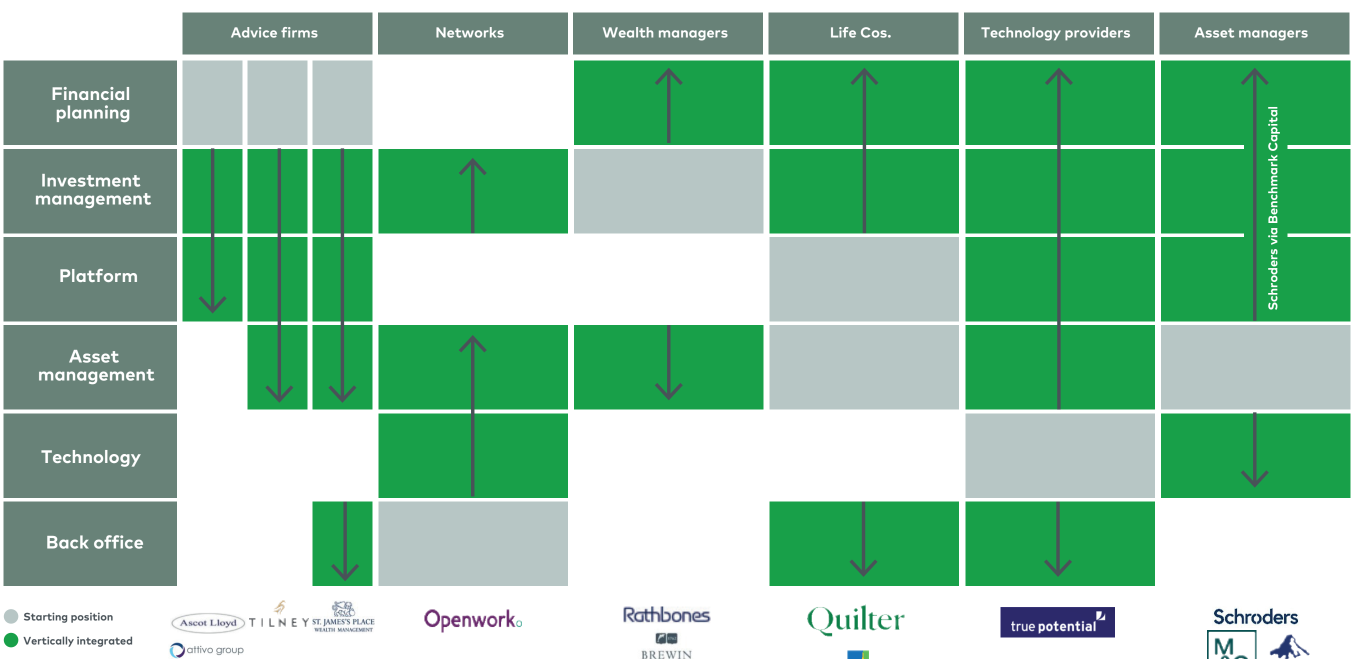
The past decade has been a landmark period of change. Regulatory change — in particular, the Retail Distribution Review — shone a spotlight on inefficiencies in the market and suboptimal customer outcomes. As a result, the fragmented (and ageing) cottage industry of financial advisors and discretionary wealth managers has become more receptive to consolidation, triggering a wave of private capital to bankroll forward-thinking management teams. A significant amount of value was created through cost (and some revenue) synergies because of consolidation. Our industry survey indicates that the level of fragmentation can support at least another 10 years of consolidation activities. In fact, very few of the c.30 consolidators in the market have industrialised their mergers and acquisitions processes to the extent that they can take full advantage of the opportunity.

Technology has played an important role in moving the consolidation dialogue further by reducing the cost of intermediation and portfolio design. This has allowed vertically integrated wealth managers to emerge at much lower scales than has ever been possible. Operating investments through a combination of model portfolios, multi-asset funds and segregated portfolios, these businesses are premised on providing both a (less scalable) financial planning service and a (highly scalable) investment management service. Instead of mostly cost synergies, vertical integration has enabled revenue synergies of up to 100 basis points in consolidation events.

Multiple flavours of vertical integration have emerged, but they largely mirror the above strategy, with the exception of asset managers who have recently forward-integrated with technology providers to access and protect upstream markets and flows (see Figure 4).

Figure 4

Examples of vertical integration



Source: L.E.K. analysis

Being vertically integrated is increasingly 'table stakes' if one wants to participate in the Financial Advisor consolidation game. FA book valuations, which a decade ago were around 1% of assets under management, have crept up to over 3%-4% on market level, with some consolidators (e.g. True Potential) now offering 8% for eligible assets. The only way for acquirers to break even in a reasonable period is to have a profit engine that monetises all layers of the value chain — including financial planning, platforms, model portfolios and/or sub-advised funds.

A resilient market

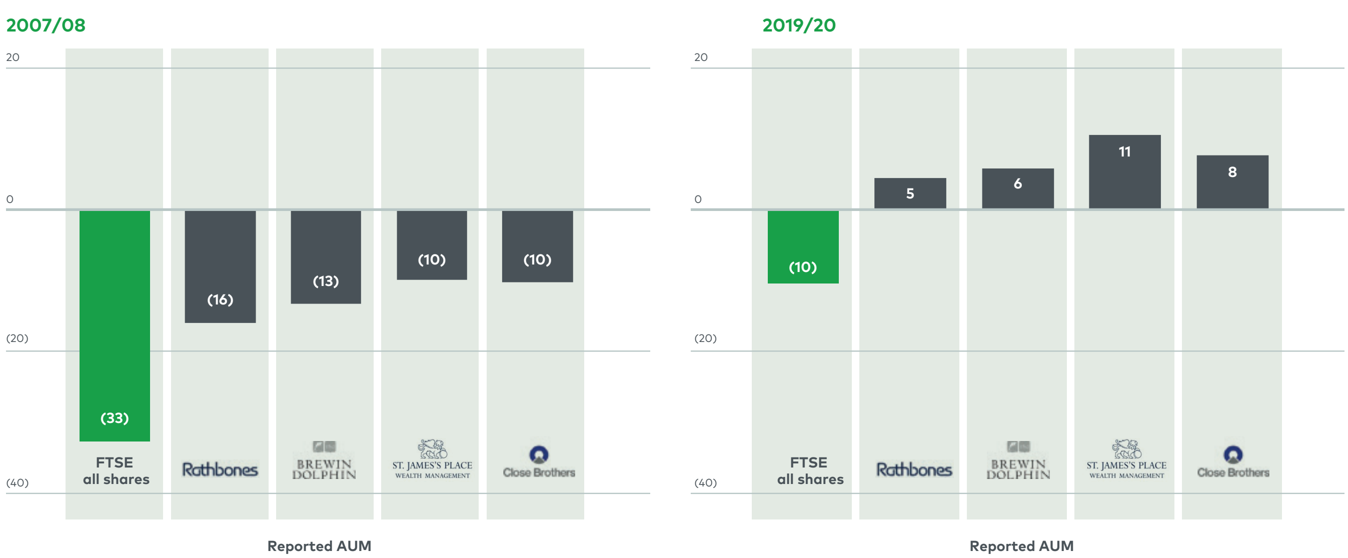
As we emerge from the economic disruption wrought by Covid-19, it is natural to ask what the impact of economic downturns has been. History demonstrates the long-term stability of the UK wealth management industry, despite stock market volatility. The advisory community's primary focus is on asset protection, and L.E.K. research has shown that it has been largely able to insulate itself from the full impact of historical stock market declines (see Figure 5).

Figure 5

Wealth management AUM performance versus stock market performance

Assets Under Management (AUM) of wealth managers declined less than the stock market in 2007/08 and 2019/20

Effect of FTSE index declines on selected wealth managers' AUM (2007/08 and 2019/20 year-on-year change)



Source: L.E.K. research and analysis

Opportunities abound

Value-creation opportunities remain significant for both current and new participants in the UK wealth management industry. The industry remains in a state of flux and business models continue to evolve, but businesses still lack agility and embedded technology. Customers are often exposed to a 'one size fits all' approach that is neither desired by the client nor optimal for the provider. The full power of technology to harmonise business processes is also still to be realised. These areas represent as much an opportunity as a threat to current market participants. In addition to vertical integration and consolidation, the need for organic growth will only be amplified in the coming years as private capital seeks exits. L.E.K. sees the role of technology-enabled business models and customer management sophistication growing as a result, while enabling significant further value creation in the industry.

About Ashish Khanna
Ashish Khanna is a Partner in L.E.K. Consulting's London office. His primary focus areas are financial services (insurance, asset/wealth management, specialist lending) and new mobility, where he advises clients navigating disruption in transportation technology across sharing, connectivity, autonomy and electrification challenges. He has substantial experience in strategy, decision support, mergers and acquisitions, and performance improvement projects across the UK, European and global markets.

About Eilert Hinrichs
Eilert Hinrichs is a Partner in L.E.K. Consulting's London office. He has 20 years of consulting experience and is a senior member of L.E.K.'s European Healthcare Services Practice and European Financial Services Practice. In both sectors he has completed a large number of assignments across Europe, working closely with senior management teams in addressing key strategic issues, developing market entry strategies, improving commercial effectiveness, and providing transaction support on both the buy and sell sides.