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**Research Thought Piece**
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# 2018 Summer Essay Series, Part III: Managing Wealth

In our first full summer in business in 2007, we decided that our clients might benefit from an attempt to discern signal from noise. We published a series of five essays entitled, *Five Themes for the Next Five Years*, which attempted to break from the daily grind of government statistics and conventional wisdom to put forth our take on the major drivers of securities prices over the longer-term. We still get regular requests for the bound edition, and its popularity has led us to continue the practice of publishing long-form thought pieces every summer since. Our 2017 effort, *Peak Passive*, examined the growth of indexation and the future for active managers. This year we extend this framework and look at *The Future of the Investment Industry*. In the first installment to this summer's series, Jason Trennert and Chris Verrone dug into the institutional securities business; in the second, Don Rissmiller, Erica Comp, and Tom Tzitzouris looked at the impact of demographics, education, and the swinging pendulum of investor and consumer attitudes. In this third installment, we attempt to bring these two threads together as we think about the paradigm shift underway in the wealth management corner of our industry.

Over a cup of coffee in Bryant Park on a recent sunny New York afternoon, I continued a decade-long conversation with a good friend and mentor (who also happens to be a very prominent and respected analyst), "NB if I was younger, I'd start a new firm. The market needs Win Smith's old Merrill Lynch, somebody out there has to just sell stocks." To a fair degree, they're right. Nobody really sells stocks on Main Street anymore. On the surface, it's arguably atomistic, seemingly lacks the appropriate (or required) adherence to conventional risk protocols, and (perhaps too acutely emphasized) doesn't provide the desired level of recurring revenue to the house. But in an environment where the capacity of our analytic abilities (both human and machine) is surpassed only by the volume of available information, the idea of investing in individual businesses – that also happen to fall within the bands of an holistic, risk-based, asset allocation – with the long-term goal of building a nest egg doesn't really seem too far out of bounds, does it? Of course, it wasn't lost on either of us that as we chatted, we sat in the shadow of Bank of America's hulking, steel and glass Midtown headquarters from which the Thundering Herd is now

directed; and, like their peers at most of the wire house wealth management divisions, directed to sell… products, and to provide services as varied and value additive as philanthropic planning, health and wellness coaching, and household technology consulting.

## Fortunately, it's (Still) a People Business

Most industries evolve and adapt over time – they have to, in order to survive and to thrive. While much about managing wealth has changed since Charlie Merrill and Win Smith's day, one could argue that the shifts taking place in the industry today are as acute as any in the modern history of wealth management. In just the last five years agents of change have: resulted in the proliferation of a new, multi-trillion dollar – with a "t" – product class (ETFs), brought another into the mainstream (private company investing), with the nascent beginnings of a third just emerging (crypto); created a new multi-billion dollar peripheral industry (fintech); markedly expanded the service offering demanded by an increasingly financially affluent client base; opened doors to exciting areas of innovation (blockchain, payments, artificial intelligence); produced unprecedented regulatory changes with complex operational impacts (RDR, DOL, MiFID II, GDPR) and no shortage of expensive distractions (information security threats, service provider and exchange outages). Change abounds. All of which is challenging to not only understand but manage effectively.

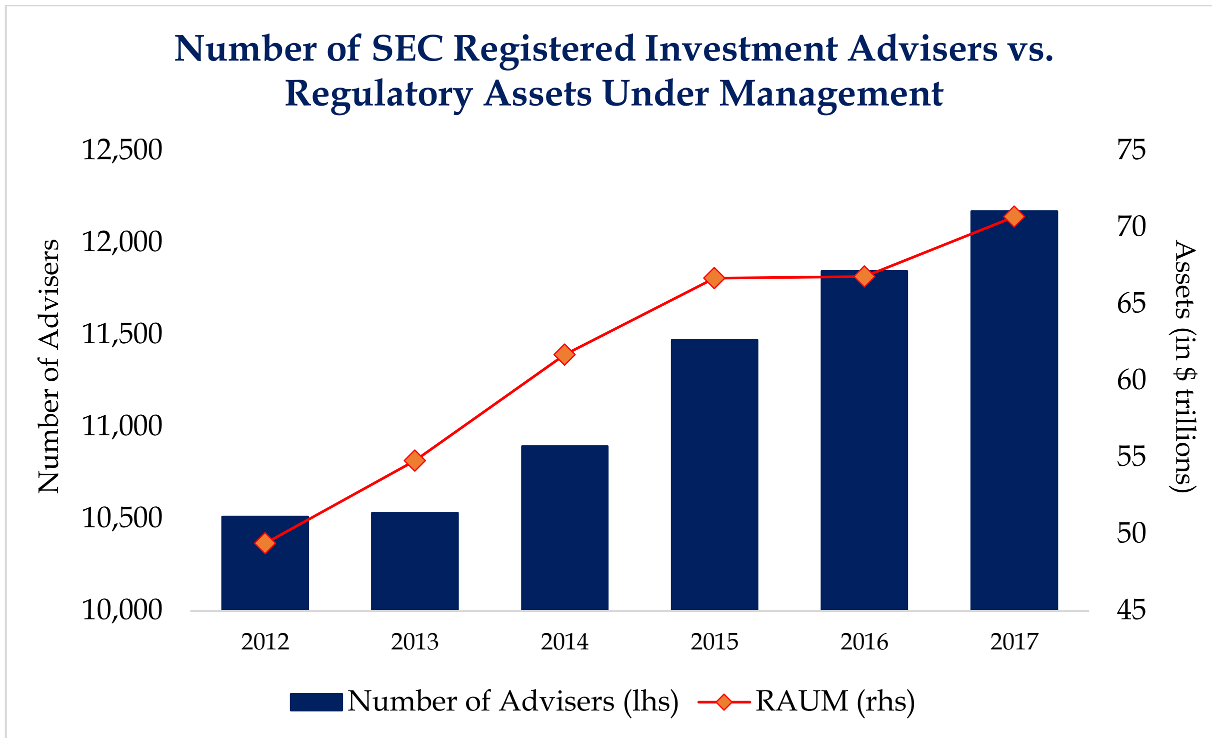
> **Despite this sweeping change, the industry remains guided by one fundamental tenet – whether measured by the health and happiness of one's family or the abundance of one's fortune, _wealth_ is and will always be _personal_. And, regardless of the seemingly limitless opportunities for science and technology to assist in improving our lot – by any definition – its management remains a people business.**

In any professional services industry the two most critical elements are the client and those who are in their service. Thus, despite the high degree of attention paid to and dollars invested in financial technologies (more on that later), in the financial services industry the lion's share of focus remains on the human participants.

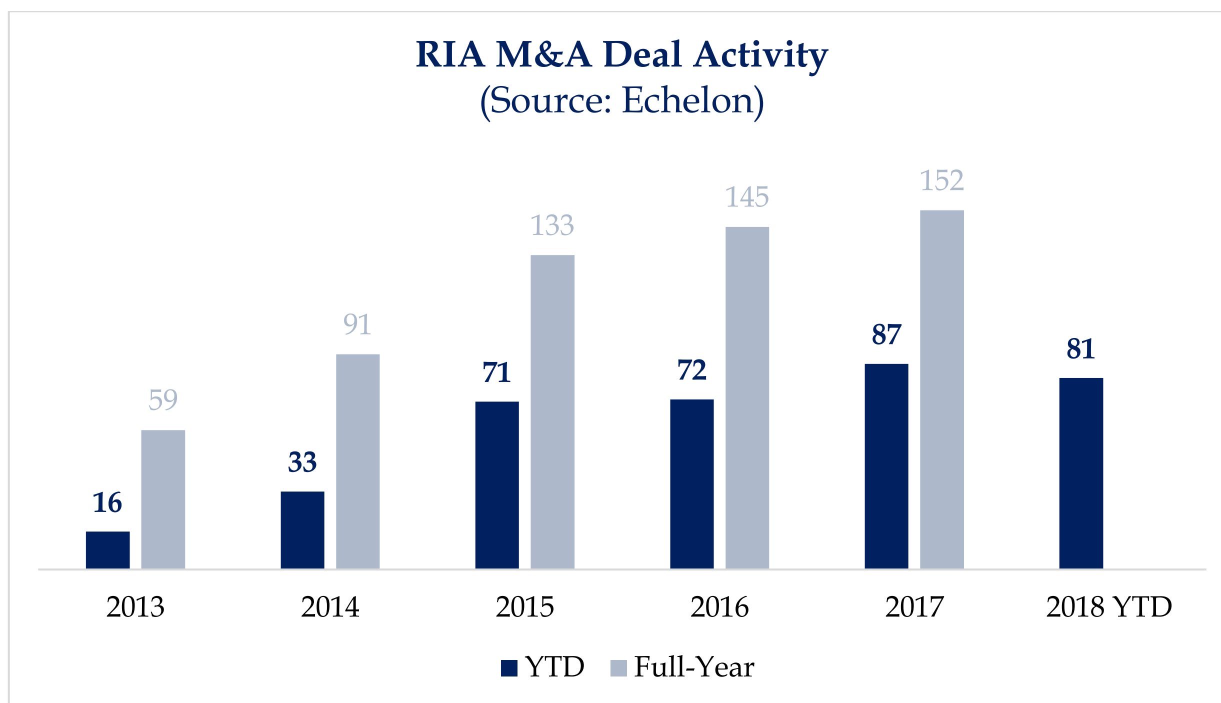
By one measure[1], there are some 402,000 financial advisors in the U.S. serving approximately 35 million clients – half of whom (51 percent) are individuals and households. With the industry's continued shift from a transactional fee model to an asset-based model – *an estimated ninety-five percent of advisory wealth practices are remunerated*

[1] 2017 Evolution Revolution: A Profile of the Investment Advisor Profession; Investment Advisor Association and NRS

*through asset-based fee schemes* – the efforts employed by advisors and firms looking to attract and retain clients and their assets has only intensified. Naturally, this elevates the importance and value of the asset gatekeepers – *established advisors, and teams, with large asset bases concentrated in well-developed generational relationships.* While employment across the financial services industry has contracted, in the aggregate, in the years since the Financial Crisis, the ranks of financial advisors has continued to grow – from 345,000 in 2012 to the ~400,000, we note above, at the end of last year – a 16.5 percent increase.




In addition to organic personnel additions, firms have become increasingly protective of retaining their advisors and the assets under their advisement. The withdrawal, late last year, by Morgan Stanley – and then UBS and Citi – from the "2004 broker protocol" stands case in point that firms, particularly larger players, are moving to protect against asset flight. The battle for advisors' business is as offensive an initiative as it is defensive. Firms are extremely intent to not only protect against advisors and assets leaving, but to recruit them, either by lifting them out of other firms or rolling-up boutiques wholesale. Merger activity is up markedly in the segment.




Advisors know the value of the relationships they have built with their clients. They're ultimately based on trust, and advisors with deep-seeded relationships know that they really only have one opportunity – *that is truly in their clients' best interest* – to switch firms. (Some who have founded boutiques have taken a second bite of the apple by seeing clear to have their firm acquired – a merger is not viewed as moving.) And, advisors are not shy about looking over the fence. Whether their motives are pure – *with the clients' best interests as their guide*, entirely selfish – *with the advisors' personal economic calculus driving the bus*, or some blend of both, I would mark variations of, 'what is the best firm to work for?,' third after, 'where are we in the business cycle?,' and 'what is the right multiple?' as the most frequently asked questions I have consistently been asked by advisors in my travels over the last ten years.

Historically, the battle for the affections of an advisor looking to change firms would have been set off among the wire house brokers and a clutch of well-established regional firms. Even then, it was only in the mid-'90s when advisor migration became at all common. The next decade (1995-2005) brought the final shift away from the transaction fee model employed by "stockbrokers" to the asset-based recurring revenue model used by "financial advisors." (On average, $800 million is spent annually on business cards, by the way.) At the same time the industry underwent the first wave of consumer-facing technology innovation with the emergence of "e-brokers" eager to turnstile every dollar looking to find a home in the Tech Boom. These developments, occurring more than a decade ago, fostered two important schisms that underpin much of the structural change in how wealth is managed today.

In one way, *what was old is new again*. The importance of the fiduciary and the provision of holistic, relationship-driven, risk-based advisory services has moved firms to again covet the same affluent clients that bank trust departments worked for 50 years ago – there are just so many more of them. We will explore the re-emergence of the fiduciary and ponder some of the implications on the business in the next two sections, **The Changing Client Landscape** and **The Business of the Business** (see page 12).

In another way, *we have only just begun to explore the reaches with which the industry can leverage technology*. We attempt to put some structure to the myriad nascent areas of development and seemingly endless impact technology will have on the industry in **The Influence (and Limits) of Technology** (see page 17).

## The Changing Client Landscape

For all the attention paid to advisors and assets under management, the most important person in the business is, of course, the client. Attempting to size the market results in widely divergent estimates, but all frame a multi-trillion dollar asset pool. A 2017 IAA/NRS study[2] places RAUM (regulatory assets under management) at upwards of $70 trillion – of which households represent ~$12.5 trillion. Another from PwC[3], estimates that investable assets are set to increase from around $64 trillion today to $102 trillion by 2020. A 2018 Cerulli survey[4] sizes the addressable household segment at $48.5 trillion – with the largest sleeve (~$20 trillion) already managed, in whole or in part, by a financial advisor and another $17 trillion currently self-directed. (An estimated $9.5 trillion of the self-directed $17 trillion is held by households with $2 million or more.) And the ranks of the financially affluent had also continued to grow. In 2017, the number of U.S. households with at least $1 million of assets, above and beyond their primary residence, reached 10 million for the first time – ten million millionaires, that alone is $10 trillion. Consider that this same measure of million dollar households dipped below six million at the depths of the Financial Crisis and it is little wonder that wealth preservation has jumped up in rank among investors' most important financial goals. Along the same line, 45 percent of financial advisors report having at least one pension plan or profit-sharing plan as a client; Cerulli sizes the addressable market at an estimated $15 trillion (not including plan participants or state or local pension plans).

Not surprisingly, client acquisition remains a strategic priority among advisory firms. Success in landing new clients is driven, in large part, by referrals from current clients and

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[2] 2017 Evolution Revolution: A Profile of the Investment Advisor Profession; Investment Advisor Association and NRS.
[3] Asset Management 2020: A Brave New World; PwC, 2018
[4] U.S. Retail Investor Products and Platforms; Cerulli, 2018

from centers of influence (lawyers, accountants, etc.). At the fastest-growing firms, existing client referrals drove 6 percent of new asset growth in 2017, while the contribution hovered closer to 2.5 percent for all other firms.

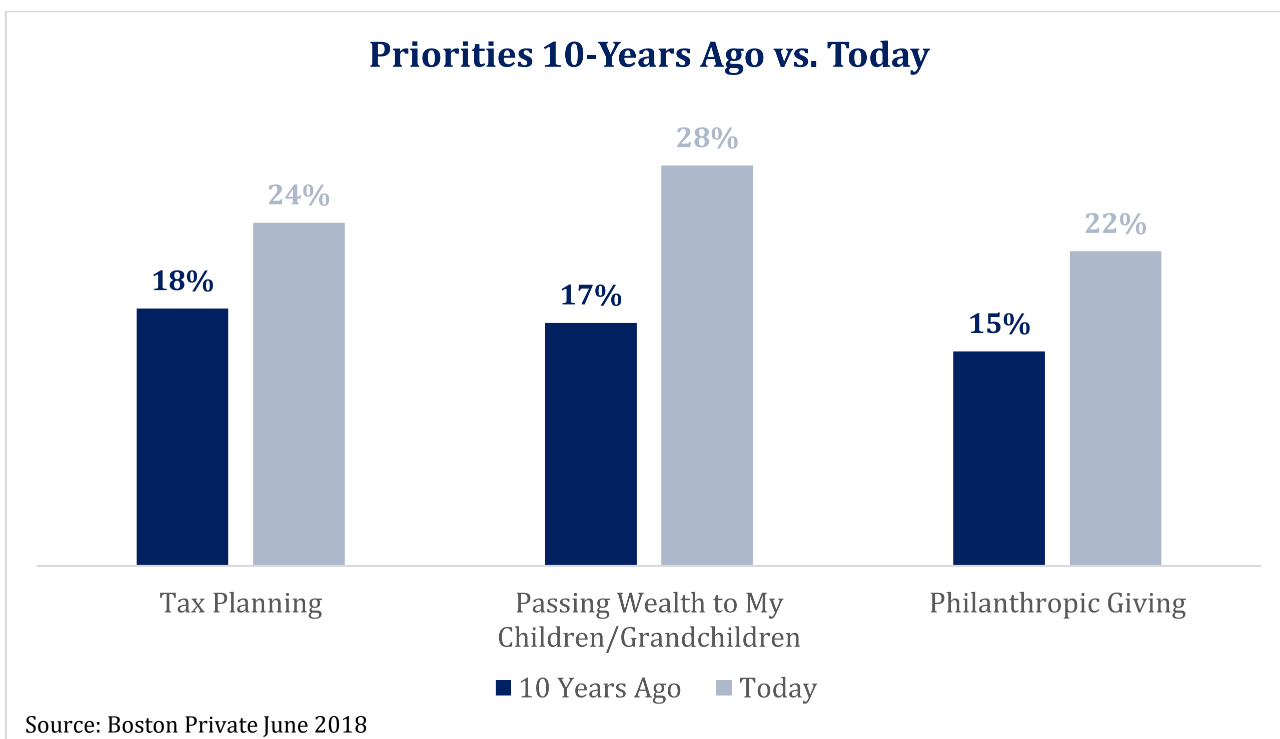
In Win Smith's day, stockbrokers sold stocks. Each stock had a story and the broker needed to convince the client of its merit to get the order. Setting aside bad actors, the move to discretionary account management relieved both the advisor and client of this burden. While clear advancements have been made with-respect-to holistic, risk-based financial planning, an unused muscle will atrophy over time. If an advisor isn't interacting with a client frequently – the longer-term *needs* of all their clients begin to look similar. Thus, an educated client is a better client. When the advisor and client are working in partnership, what a client *wants* can be prioritized with what a client *needs*. This may seem counterintuitive, but greater financial literacy on behalf of the client requires a level of initiative and bespoke planning that affords the degree of thoughtful consideration one-size solutions do not. When a clients' short and long-term objectives can be weighed against the secondary, or even tertiary, implications of a strategic plan the point at which *want* and *need* begin to align. Conversations with clients yield three areas where the traditional advisor-client relationship playbook is being upended:

1) Generational Wealth Transfer

I spoke with one successful, early-forties private banker recently who cited: the preponderance of graying clients his firm represents, the aging teams of advisors in their service, and a discernible lack of planning by firm management to manage the impending generational shift in wealth and the inevitable wave of advisor retirements, as material risk to both his business and his career. He put it to me this way, "I can take my book and go to another shop or I can try and get in with a few of the old timers and hope a few things break my way. I've been here since law school; I want to stay, but believe me NB, they don't get it." This is a successful guy at a name brand firm; unfortunately, he's not alone.

There are some 35 million U.S. households, representing total assets of $6.7 trillion, with a head of household aged 55 to 69. One study[5] put at two-thirds, the percentage of clients over 60 in the average advisors' practice. In a shift from ten years ago[6], there have been notable changes among investors' priorities, particularly: tax planning (24 percent, up from 18 percent); passing wealth to successive generations (28 percent, up from 17 percent); and, philanthropic giving (22 percent, up from 15 percent).

[5] "Millennials and wealth management: Trends and challenges of the new clientele; Deloitte, 2018
[6] "The WHY of Wealth Survey"; Boston Private, June 2018




As Don Rissmiller discussed in Part II[7] of this series, shifting demographics are worth paying attention to as baby boomers begin to enter the wealth transfer stage of their lives. It is estimated that over the next 30-40 years around $30 trillion dollars will be passed onto heirs. This is both an opportunity and a risk to your practice. Every advisor we spoke to for this piece said that their firm had a plan in place for getting in front of, and building a relationship with, their next generation client. Many however, like our friend above, questioned the impact the house plan would have and doubted, frankly, whether it was even being widely adopted by their colleagues. Naturally, most also felt *they* had a "good handle" on succession issues as it related to their own clients. Unpacking that further suggests that advisors' confidence stems more from a belief they are satisfying their client's – *the wealthy elder's* – intentions than it does from establishing a relationship, on its own merit, with the successor generation. We would rate this as a greater issue than many practices believe that it is.

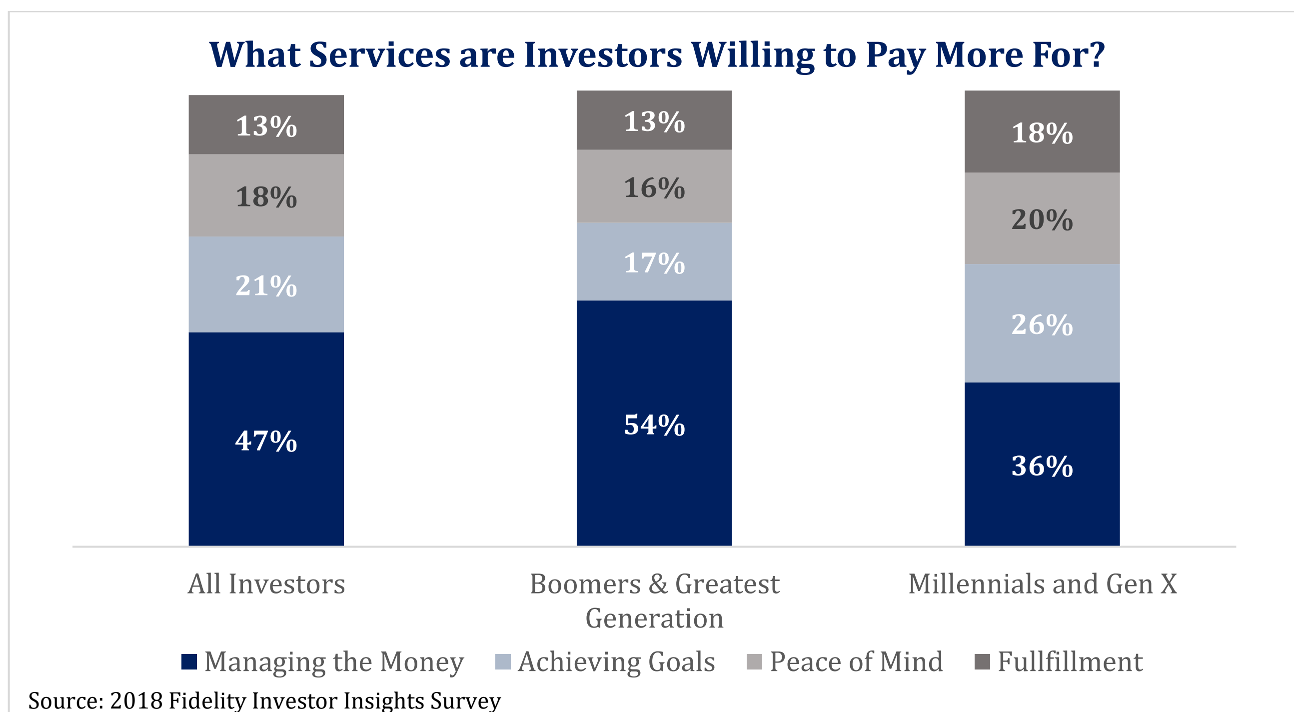
2) Customizing the Client Experience

The Tech Bust pushed sentiment for single stocks to secular lows. The product cycle which filled its void left investors far from satisfied with their returns and, in the throes of financial repression – which came in the wake of the Crisis – increasingly suspect of the fees they were paying. As such, and with the universal ability of technology to deliver information in real-time, individual investors increasingly expect the same information –

[7] Research Thought Piece, *The Future of the Investment Industry, Part II: Demographics, Education, and Changing Attitudes*; 8/10/18

if not access – enjoyed by institutional investors. The combination of transparency and access, timeliness of communication, and having been burned twice in an 8 year span (Tech Bust & Financial Crisis), individual investors' financial literacy quotient has increased markedly. This combination has resulted in a feedback loop – *that we view positively* – which has transformed what was, until recently, a rather opaque corner of the industry. Of course, this fosters clients' expectations of improved, and increasingly customized service. For boutique and independent practices this largely amounts to time. Time spent with the client and their family to better understand their *wants* and *needs*. Time researching and choosing from the broad and endless range of investment options. Time preparing a thoughtful plan which specifically addresses these *wants* and *needs*. Time.

This investment in time can be an obstacle in scaling your practice. For larger practices, as an organization grows, or for firms with more complex product approval and risk profiling modules, the more these decisions end up being governed by scale. At some level, this is appropriate for running a business. In response, many organizations have undertaken to segment their client base vertically, into four or five segments based on asset size – 1) self-directed; 2) small account and retirement plan participant, *less than $500,000 in AUM*; 3) private client group, *between $500,000 and $2-3 million*; 4) private banking/high net worth, *between $2 million and $20 million*; and 5), family office, *$20 million, and up* – and assign service levels accordingly. These ranges are fluid and investors will place their assets at the firm where they feel they will receive the greatest degree of attention. While data suggest segmentation along the AUM hierarchy and the provision of services to each segment provides – *through a more efficient allocation of resources relative to expectations* – an improved client experience, the true benefit accrues to the advisor's P&L. There is sufficient empirical and anecdotal evidence to suggest that the industry, knowing enough to identify the challenge that client customization presents, has struggled to really address the value proposition expected by the client. The challenge will be for advisors to narrow the gap between the levels of service sought by the client and the, all-to-often, commoditized product provided by the firm. An interesting study from Fidelity highlights that investors place a premium – *and are willing to pay higher fees in the aggregate* – for: "achieving goals," 21 percent; "peace of mind," 18 percent; and, "fulfillment," 13 percent – or, 52 percent vs. 48 percent for "managing the money." This split was particularly acute among younger demographic groups – 64 percent to 36.




The primary example, mentioned repeatedly in our conversations for this piece, where personalizing the client experience has historically come up short and about which there is no shortage of research framing the "problem," but little material addressing widespread success, is the experience of women as consumers of high-end wealth advisory services. It has been cited in numerous publications that women own roughly half of the investable wealth in the U.S. and influence an estimated 80 percent of a household's spending. Yet, just 15[8] to 25[9] percent of wealth advisors are women. Enduring client-advisor relationships are grounded in partnership and with the advisor's understanding of what is truly important to their clients – whether they be women, or men. Of course, in order for this partnership to be authentic, it must extend far beyond her finances. We might suggest that advisors begin by addressing her unique *wants* and *needs* and <u>not</u> by pre-conceptions about a homogeneous group.

Every single client *wants* and *needs* to be understood and serviced in a personalized way. The "one size fits all" model is challenged.

3) The Rise of the Millennials

Why would defining Millennials in the aggregate by one's pre-conceptions, or by any number of misconceptions, be any less ill-advised than it is to do so with women investors? We are compelled by this observation: the industry's transformation, which we discuss

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[8] 2018 Outlook for US Wealth Management: "The Year of the Client"; Foster, L & Rudin, April J., 1/24/2018

[9] The Certified Financial Planner Board of Standards estimates 23 percent of financial advisors are women

throughout this piece, is playing out concurrently with Millennials aging fully into the workforce and approaching the period of their lives when – *traditionally* – young adults begin to consider their financial wealth and other long-term *wants* and *needs*. At the same time, inasmuch as convention does not appear to apply as readily to this group, the advisors managing the business today and building it for tomorrow are of an older generation with strikingly different views about money and wealth. But, as the saying goes, "the client's always right," and given the sheer magnitude of generational wealth transfer forecast to occur over the next 20 to 30 years (approximately $30 trillion[10]), at roughly the same time Millennials reach their prime earning years, it might be worth focusing on.

Coming of age in the years following the Financial Crisis has had a material impact on Millennials relationship with money; they are savers, but not investors (52 percent of their assets are in cash[11]). Coming of age in a period of tremendous technological innovation, particularly personal technology, has informed Millennials' comfort with technology in their daily lives; its ubiquitous (25 percent of Millennials spend more than 5 hours on their mobile device every day[12]). Coming of age in an era of notable political volatility and polarization has engendered Millennials to seek value in a greater sense of purpose and social mission; they care (77 percent have consciously made investments based on social impact and ethical business practices[13]).

Financial education will play a critical part in providing advisory services to millennials. A Deloitte study on millennial investing offered this:

> "Many millennials possess a low-to-medium level of financial knowledge. For these clients, wealth management firms need to find out how strong the interest for a deep financial understanding is. If the need to get deeper insight exists, wealth management firms are obligated to find a way to educate the client on financial terminologies and products based on the prevalent knowledge. The language that the wealth managers use, has to be clear, simple, and understandable for the unexperienced millennials."[14]

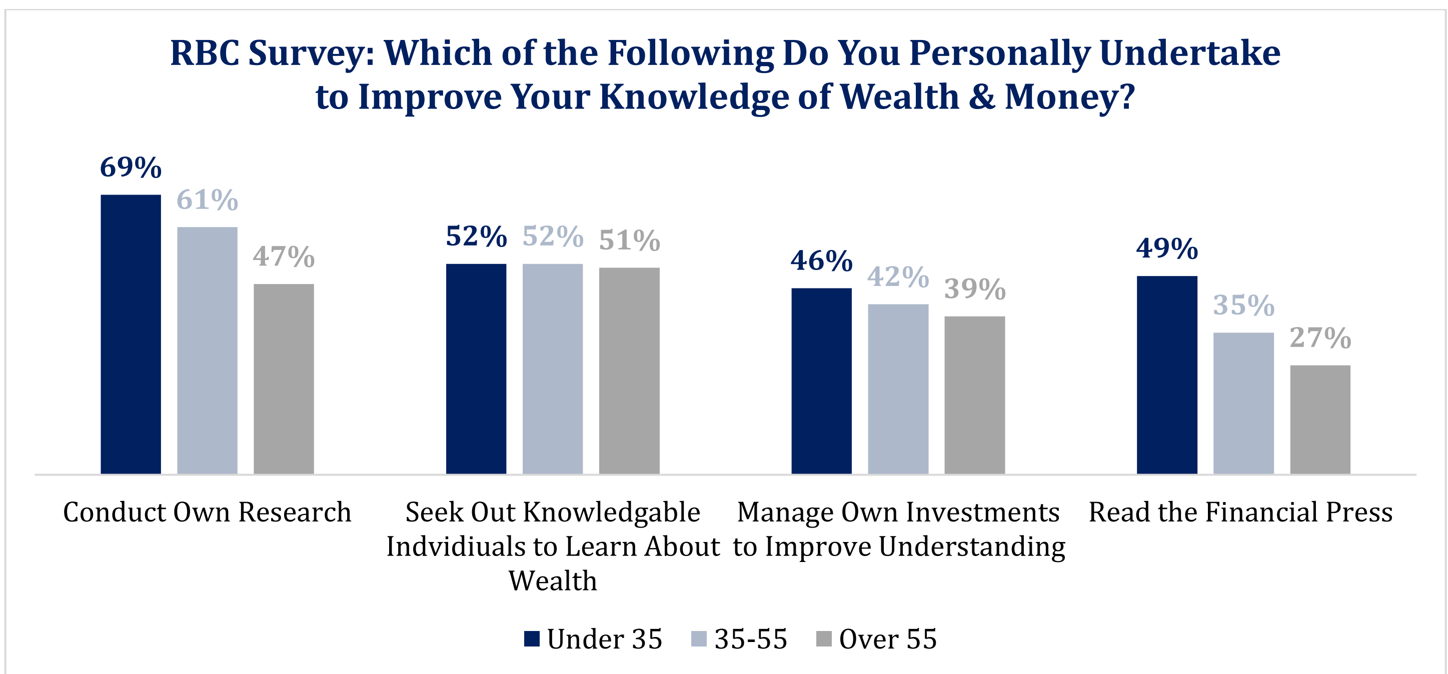
Really? That's pretty bleak. The same whitepaper notes the proclivity of millennial investors to consult multiple sources – including the media and peers – before making an investment decision, with a particular emphasis placed on word-of-mouth and personal recommendations. On its face, there appears to be significant hurdles to clear on both

[10] Managing Millennial Money; PwC
[11] The Rise of Affluent Millennials; Efma
[12] Smartphone and IoT Consumer Trends 2017; B2X
[13] Impact Investing: At a Tipping Point (2018); Fidelity Charitable
[14] Millennials and wealth management: Trends and challenges of the new clientele; Kobler, Hauber, and Ernst (Deloitte)

the financial literacy front and with respect to the traditional client-advisor relationship baseline. Mercifully…

> "Millennials have grown up with instant access to information, making them the first truly hyper-connected generation. As a result, they have an insatiable appetite for knowledge: 80% of high net worth Millennials surveyed feel responsible for understanding their own financial affairs, and a significant proportion believe it's up to them to acquire financial acumen and build their confidence in wealth matters…"[15]
>
> Indeed, "64 percent of Millennials feel they understand their holdings and investments as well as a professional… [though] four out of ten Millennials are currently more focused on short-term goals and want tangible advice to help them reach those targets. Conversely, four out of ten are interested in planning for retirement, seeing that as a core long-term goal."[16]

This would seem to be validated by an interesting anecdote from the recent "The WHY of Wealth Survey" conducted by Boston Private. Among all respondents, the most desired quality in a professional financial partner was "investment performance" (43 percent and 46 percent for folks over 50) while millennial respondents cited "transparency" as the primary attribute they desired in a financial partner (49 percent). (For all investors, the importance of fees – with just 20 percent – was last.)




[15] Millennials and wealth transfer: A generation poised for responsible wealth transfer; RBC Wealth Management
[16] Millennials and Money (2018); Accenture

A battery of studies show that Millennials desire a financial partner that is digitally connected and can assist in their financial education. That said, relative to older generations, they are also far more interested – and comfortable – executing their own transactions. The sluggish response to this shift in preference by traditional financial services firms (which we discuss in greater detail below in **The Influence (and Limits) of Technology**) created a tactical opening for a rash of financial technology start-ups and non-financial operators to compete for Millennials business. Interestingly enough, while 57 percent would change their banking relationship for a better technology solution, comprehensive tech-only wealth solutions are not considered a trusted source for advice.[17]

It is any wonder why this group is marked as challenging…

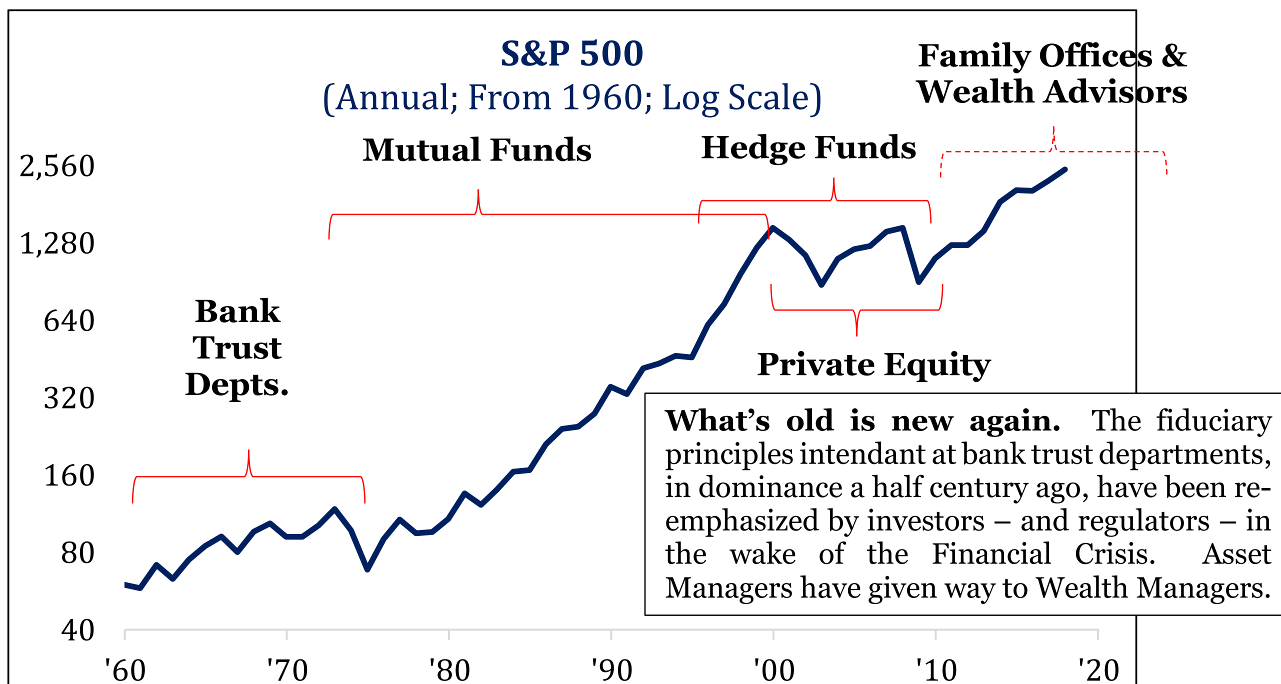
## The Business of the Business

While it would appear that the various disciplines within the industry have enjoyed a generally peaceful and collaborative coexistence, their relative importance within the prevailing business model of the day has frequently fluctuated…

> In the 1960s, when the average holding period for a stock in the United States was a stunning 8 years, bank trust departments were the principal buyers and sellers of securities. The invention of the CMA in the 1970s and the bull market of the 1980s led to the growing influence and near-dominance of the mutual fund industry for much of the next two decades. The bursting of the Tech Bubble contributed to the search for "absolute returns" and the ascendance of hedge funds, while Wall Street research scandals, the increasing availability of cheap money, and the heightened regulatory burden placed on public companies led to the re-emergence of private equity. Then the Financial Crisis… *fool me once, shame on you; fool me twice shame on me.* After accepting the value proposition of asset managers and capital advisors prima facie for more than a quarter century, sub-par returns and "giffen good" pricing proved important catalysts for investors and their advisors to begin to take back the reigns of capital allocation; the proliferation of exchange traded products (ETPs) and fintech innovation created a new template for asset allocation.[18]

[17] "Millennials and wealth management: Trends and challenges of the new clientele; Deloitte, 2018

[18] Research Thought Piece, *Peak Passive: Thinking About Asset Allocation*; 7/21/17



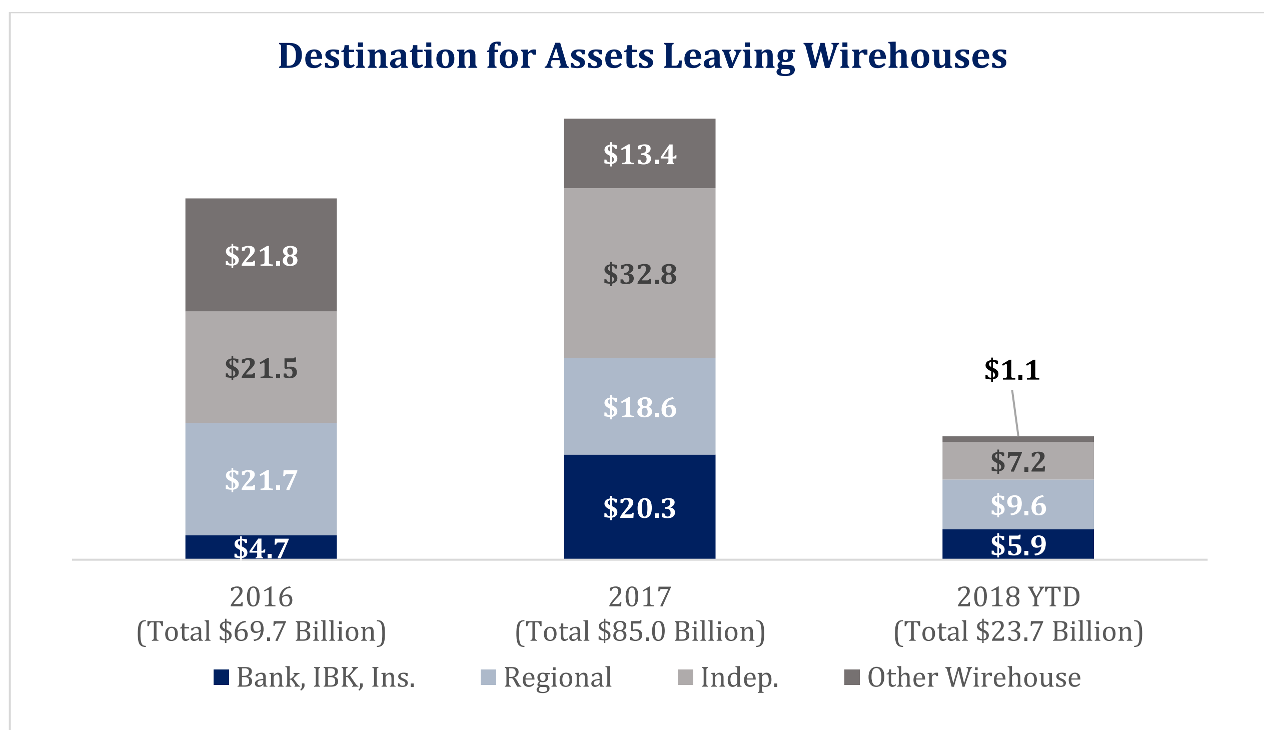

Advisor migration only intensified in the vacuum of the Tech Bust and as the reputations (and fortunes) of the financial supermarkets spiraled during the Financial Crisis. Advisors looking to a fresh start championed a new wealth advisory segment – boutique RIAs (registered investment advisors) and independent (branded and non-branded) platform firms. This segment exploded with the proliferation of TAMP (turnkey asset management programs/platforms) and a la carte technology solutions aimed at allowing advisors to build businesses outside the wire houses and regional framework that focused their practice on the suite of services they viewed as most valuable in maximizing client engagement, while effectively outsourcing the balance.

> **The four pillars of quantifiable advisor-created value are: Financial Planning; Asset Class Selection & Allocation; Systematic Rebalancing; and Tax Management.**[19]

The proliferation of boutique and independent RIAs has been pronounced. In 2017, 10,700 advisory firms (87 percent) reported employing 50 or fewer individuals; roughly 6,900 (57 percent) of RIAs reported employing 10 or fewer non-clerical employees. The preponderance of tangible financial wealth in the U.S. is the result of entrepreneurial activity. It should surprise no one that those advising the entrepreneur class would look to scratch the itch themselves. Sometimes the best firm to work for is your own.

[19] Capital Sigma: *The Sources of Advisor-Created Value*; Envestnet | PMC, 2016

In addition to the number of advisors migrating away from the wire houses, the shift in assets continues to favor boutique and independent advisory firms and regional firms. In each of the last three years (CY'15-'17) departing advisors have enticed clients to shift $130 billion – each year – from the firms they were leaving to their new firms. Of the $130 billion moved in CY'17, $85 billion was transferred from the wire houses with $33 billion moving to independent advisory firms and $18.5 billion was transferred to regional firms.




But don't get too down on the prospects of the large, resource-rich, multi-line firms. Their standing with advisors, like the market, bottomed in Crisis and while they have not seen advisor and asset growth as robust as in other advisor cohorts, as a group, they have not been altogether far behind. Tangentially, some platform service providers (both branded independent RIAs and tech-driven TAMPS) have struggled to build durable economies of scale. This had led to further roll-up and for advisors to concentrate trillions of dollars on larger, more established wealth platforms. Any questionable decision that could serve to damage the clients' confidence in the ability of the advisor and her firm to effectively manage their needs presents significant risk to the practice. This favors the established firms.

As the complexity of an advisors' practice and the breadth of service their clients require (and demand) continues to grow, the limits of a smaller, private practice are pressured. While many independent advisors are happy to manage – and, ostensibly, their clients are

willing to accept an army of third party professional service providers (bankers, accountants, lawyers, trust, insurance, etc.), getting the "in-house-to-third party" service mix right and, in turn, partnering well, is critical for independents to balance the dual challenges of providing exceptional service to the client with the realities of managing the P&L and signing the front side of a paycheck. It's not for everybody.

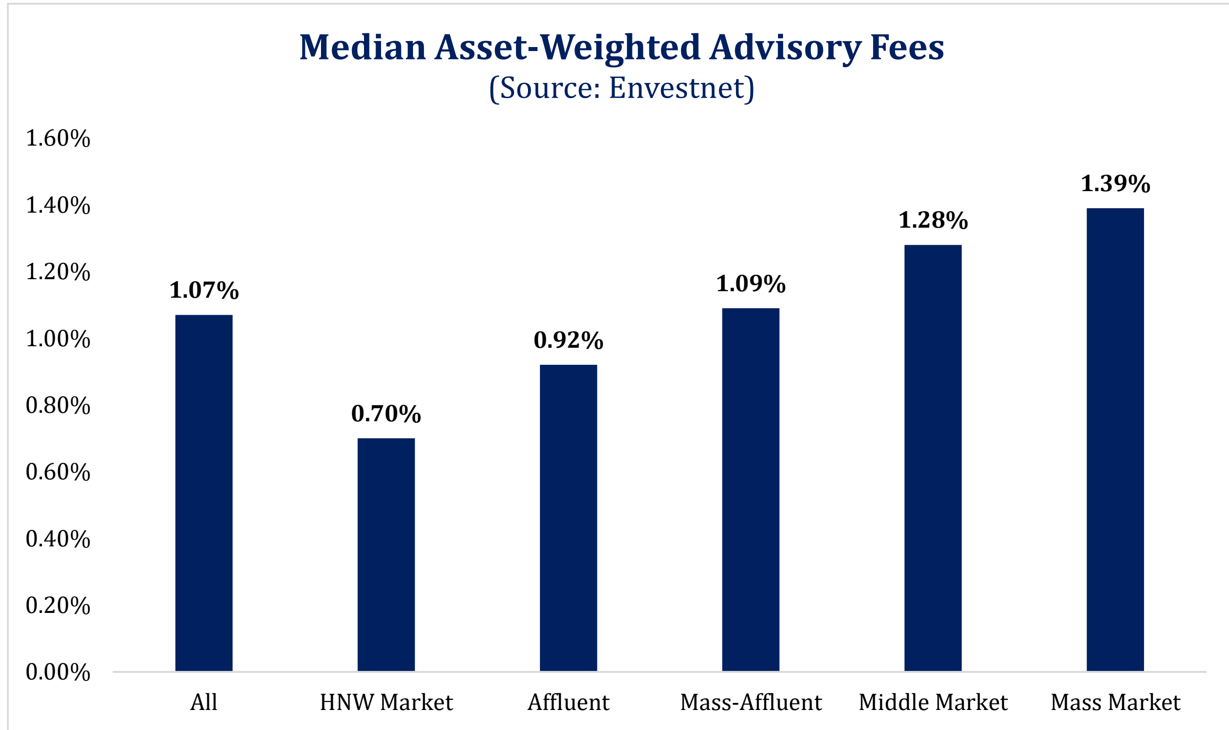
Though no single model has emerged as wholly addressing the sweeping changes underway, there is a gnawing sense that the traditional product-based wealth manager whose practice is largely focused on the management of financial assets may come under the most acute pressure. To combat this, many firms, particularly the once-suffering wire houses have taken to offering a range of services meant to provide a total wealth solution. These include: wealth analytics & solutions; manger selection & portfolio construction; trust services; personalized estate & financial planning; philanthropy management; lifestyle advisory; single family office advisory; family governance & legacy; insurance solutions; technical insights; and, cash management & lending, among others. But while the breadth of available services and depth of expertise available to clients of diversified practices plus the imprimatur of well-established, respected, and generally resource-rich wire house and regional firms can be an alluring draw for advisors and clients alike in the same IAA/NRS survey we cited earlier, 60 percent of advisory firms indicated they provide no substantive service beyond rendering investment advice. The addition of cost without increased profit is generally not a good recipe. As the industry continues to evolve, a variety of factors will impact a firm's business model and their service mix – profit likely chief among them.

In the same way there has been wide spread fee compression on the product side of the business (asset management), fee levels on the advisory side (wealth management) have also been under some pressure, though not as acutely. Asset-weighted average fees for active U.S. equity products fell -5.2 percent to 73 basis points in 2017 from 77bps in 2016 and declined -8.3 percent to 11bps from 12bps, the prior year, for passive U.S. equity products. Asset-weighted advisory services, however, have remained relatively flat despite the intense pressure to gather assets, averaging 107bps across all economic sleeves, with some discounting offered to larger ($10 million plus) and long-standing clients and to open new client relationships. That said, while fee compression is near-universal on the product side of the business and evident to a degree, in the aggregate, on the advisory side, wholly 70 percent of advisors maintained – or even increased – prices in 2017.

> "Advisors who lowered their prices experienced lower growth than those who maintained or increased their price, and they attracted fewer new-fee assets.

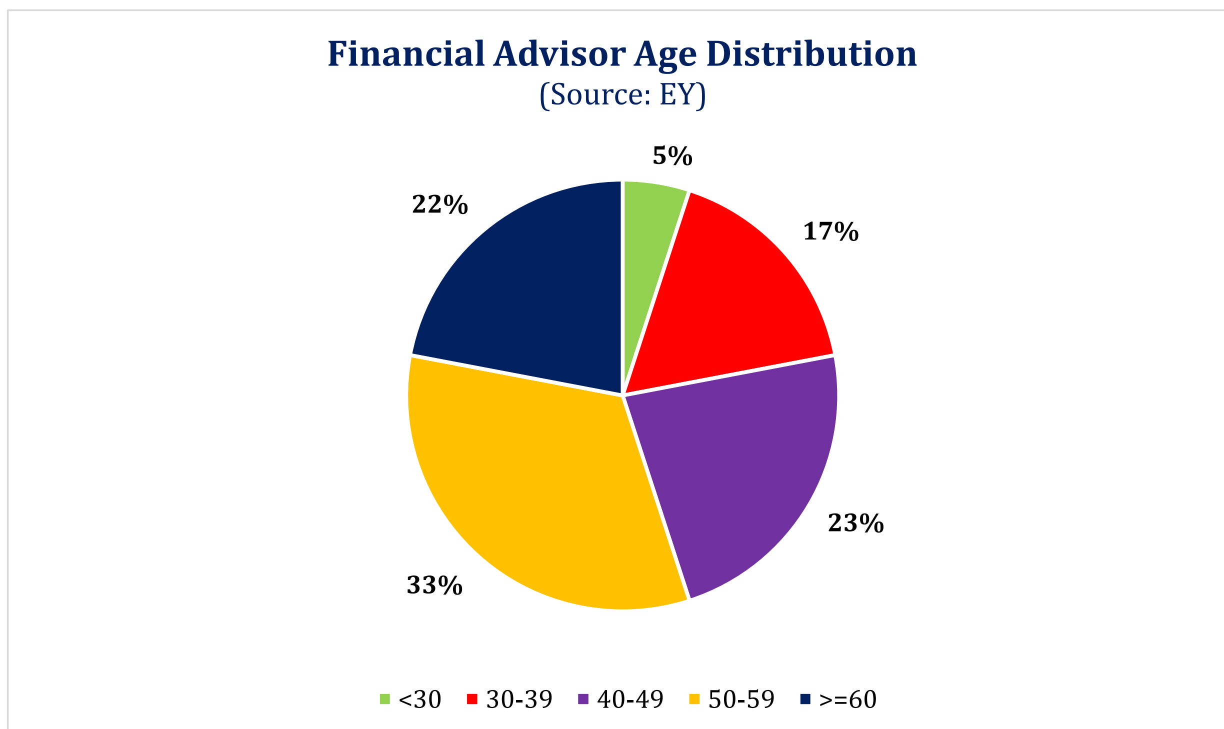
> Lowering prices to add assets and drive growth is generally not an effective strategy."[20]

From the recent "The WHY of Wealth Survey" conducted by Boston Private, among all respondents, the importance of fees – with just 20 percent – was last on the list.




Demographics work both ways. For all the focus on Millennials, one of the other principal issues facing the industry is the aging of financial advisors. The average age of an FA is now 50 years old and continues to rise every year. An EY study[21] indicates that only 22 percent of financial advisors are under 40 (and only 5 percent are younger than 30). For every graduate of a financial planning college program who enters the industry, there are two advisors who become eligible for social security benefits. Only 40 percent of older advisors have a completed succession plan. The result is a less than 50 percent retention rate during advisor succession.

[20] The state of retail wealth management in North America; Bol, Kennedy, and Tolstinev (McKinsey), May 2018
[21] EY wealth management outlook 2018; EY




## The Influence (and Limits) of Technology

A wealth management firm without a comprehensive tech strategy – in both the front and back office – is putting the franchise at risk. For the billions of dollars spent annually, the number of firms feeling they are playing catch-up (let alone keep-up) – particularly with respect to critical underlying operational and support system infrastructure – is unnerving. We hear comments from frustrated non-IT colleagues at firms all the time. More substantive conversations with clients highlight four distinct areas, in both the front and back of the house, at which firms are focusing strategic thought and financial investment:

1) B2C Solutions

While we believe there is no substitute for the importance of personal relationships in the management of wealth (however defined), consumers have become increasingly comfortable – if not reliant – on a digital gateway to perform a battery of pedestrian – and, increasingly, not so pedestrian – transactions related to their personal finances. And, though the "just-enough-to-keep-up" approach of evolving with the times has long underpinned corporate tech strategy, as evidenced by the "Amazon effect" – *the shift from mom n' pop to big block has given way to a disintermediated and commoditized marketplace where large and small enterprise alike can compete globally* – companies have begun to dramatically re-think not just their approach to technology, but for some, their whole go-to-market framework. Smaller firms have become more aspirational and commercially aggressive. Larger firms

have become increasingly vertical, expanding into markets previously the bastion of their suppliers and clients, respectively. And entrepreneurs are starting new businesses to address both niche and broad market segments every day. This has been particularly disruptive in the provision of financial services, as consumers have become intimately comfortable with technology in their financial lives. The digital gateway opened in the late-'90s with the e-brokers and has evolved into a multi-billion dollar annual marketplace for financial services. It seems that for every breakthrough by a start-up – *Robinhood (investing), Venmo and Square (payments)* – there is a headline announcing an initiative from an old line player that moves the goal posts – *JPMorgan ($0 trades), Goldman Sachs (retail banking).* In each case, struggling to keep up are earnest, albeit (relatively) resource constrained, players stuck between the noble pursuit of providing a service "modernized" by the Medici and the increasing importance of a vital channel of client engagement. These firms must keep up, but do they need to differentiate?

All wealth management firms need a client-facing strategy that involves a digital touchpoint with clients. Given that investors are increasingly involved at the point of transaction in the more complex areas of their financial lives the digital gateway must address both function and form, i.e. the solution must be generationally friendly. Clients demand – *and are entitled to* – full transparency into their financial affairs; transparency is self-reinforcing, furthering financial literacy and the clients' interest in information. To satisfy this demand, high touch advisory practices, in addition to the desired scope of transaction functionality, will need to provide a content-rich analytical and educational offering. None of it a stand-in for human interaction, but must be provided to satisfy clients' insatiable desire for information and an expectation that it is available on demand.

2) B2B Infrastructure Solutions

The trust that <u>all</u> consumers leveraging digital financial services place in the system is extraordinary. This trust compounded by widespread usage of tech-based financial solutions can also put a tremendous amount of strain on a firm's technology ecosystem. Often, this "ecosystem" is a mash-up of aging hardware, post-support software, and an army of redundant vendors, conspiring to put the firm and its clients at risk. While costs can appear prohibitive, when managed properly, a streamlined and well-constructed solution can provide the firm with dramatic operational improvement and scale.

3) B2B Enterprise Solutions

While humans remain ultimately responsible for decision making there is little question of the leverage that a software-based solution can have on any number of processes

performed by a professional service firm. In his annual letter to shareholders, JPMorgan chairman Jaime Dimon highlighted the importance of enterprise collaboration to aid in the banks' delivery of an end-to-end digital client experience – Zelle (consumer payments); Roostify (mortgages); True Car (auto finance); OnDeck Capital (small business lending); Symphony (communications systems); there are myriad others. Looking at smaller firms, Fidelity research indicates tech-savvy advisors have 42 percent higher assets under management than tech-indifferent advisors.[22] What's more, while all the rage, the impact of AI (artificial intelligence) has only just begun to be felt. In rudimentary form, AI has already replicated many of the decision-making functions of human. In many respects, we anticipate the development of AI to be among the more impactful in all areas of wealth management.

4) And, C2C Solutions

These are the early days for the development and influence of machine learning and artificial intelligence in general and for the investment industry in particular, but advisors – and their clients – must take ownership of the inputs and the impact these fast developing technologies will have on their practice. There are hurdles – which may never be cleared – before a fully-digital service offering is in position to provide a universally better experience in style and substance than a human advisor. While software can be

[22] Fidelity Finds Number of Tech-Savvy eAdvisors has Grown to 40 Percent; eAdvisors Outperforming Tech-Indifferent Peers; Fidelity, 2017

made to perform tasks that a human has to think about, it has been far more difficult to program for the tasks that a human does not need to think about. According to a 2015 Economics of Loyalty survey by Dimensional Fund Advisors the top reasons why individuals choose an advisor are: 1) a demonstrated understanding that they understand the client's needs – 69 percent; 2) the advisor helped the prospective client to see the value they could bring to the client's family – 57 percent; 3) the advisor educated the client about investing – 45 percent; and, 4) the advisor engaged in candid conversation on the typical investment performance of their clients – 41 percent. This same study also elicited responses on the personal characteristics that contributed to a client's decision to select their current advisor. The number one response, "experience in working with clients like you," 55 percent.

## Looking Ahead: The Key Takeaways

1) Wealth Management remains, above all else, a people business.

2) The attitudes and preferences of Millennials will define much about the future of the wealth management client experience.

3) The ubiquity of technology will force advisors to break with convention and develop a whole strategy for client engagement.

4) Regulation, fee transparency, and passive investing will conspire to define the price of a "unit of service." Investors value "holistic advisory services" far more than they do "managing money."

5) Advisors must continue to be collaborative and give thoughtful consideration to their clients *wants* and *needs*.

## APPENDIX – IMPORTANT DISCLOSURES

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