THE FINANCIAL PLAN: The new lifeline of your practice

ADVICENT

IN RESEARCH

INTRODUCTION

The financial advice business is undergoing a transformation.

Where financial advisors once focused primarily on investing, they and their clients are now coming to realize that the primary value of professional, human advice lies less in the identification and selection of investments and more in the ongoing financial planning that advisors provide to help clients define and reach their life goals. In short, investing is the means to an end, and financial planning helps clarify what those goalposts are.

Since most advisors already engage in financial planning in varying degrees, recognition of planning's importance and value is not a surprise. Yet as investment management becomes more commoditized and financial planning becomes more central to the advice business, advisors are recognizing that they must place more emphasis on financial planning. They also are coming to appreciate why using advanced financial planning software is becoming necessary to ensure that their planning efforts are sophisticated, compliant, manageable, scalable, and user-friendly.

As a resource for advisors who prepare to move to a more planning-centric business, this white paper will:

- Identify the forces that are making financial planning the core of the advisory business and explain why the shift is likely to be permanent
- Illustrate how financial planning software has penetrated the advisory business and why advisors believe it is important using findings from the InvestmentNews 2017 Technology Study
- Highlight best practices for fully leveraging financial planning tools and provide examples of how financial planning technology can help an advisor efficiently present customized planning solutions for clients and prospects
- Explain why using advanced financial planning software will become essential for advisors as they aim to differentiate themselves in a more regulated and competitive environment where scale will become increasingly important

WHY FINANCIAL PLANNING NOW?

The advice business is in the midst of profound change as a result of four fundamental and intertwined forces: competition, shifts in consumer demand, demographics, and regulation. Let us examine each factor—and how they are connected—to understand why financial planning will become the lifeline of advisory practices in the years ahead.

Competition and consumer demand

A variety of relatively new competitive forces are besetting the advice business and making their presence felt in the form of margin compression.

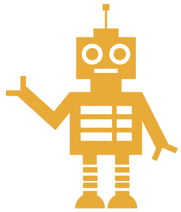
Among the most visible of competitors are the automated investment management providers known as robo-advisors. Whether standalone companies such as Wealthfront or Betterment, or part of financial giants including Vanguard and Schwab, or robo-offerings from third parties intended for use by advisors themselves, these online wealth management platforms offer simplified investment management at very low cost.

Currently, U.S. robo-advisors manage about $75 billion in assets and may grow to $250 billion in assets under management (AUM) by 2020, according to data collected by Statista, an online statistics company. In its latest report on U.S. wealth, CapGemini estimated that high-net-worth individuals would be willing to allocate $1.5 trillion to automated advisors by 2017. Among younger affluent investors, that willingness is especially pronounced, with 43.1 percent of affluent investors in their forties willing to try a robo-solution and 68.9 percent of investors in their thirties expressing a willingness.

The appeal of robo-advisors lies mainly in their low-cost, simplicity, and user friendliness for those preferring online access. In addition, another driver of their growth has been the transparency of their value proposition. With robo-advisors, it is evident what clients receive for their clearly defined fees; clients have less understanding of overall costs and value received from traditional advisors.

The low-cost investment vehicles on which the robo-advisor business is built—exchange-traded funds (ETFs)—are another competitive force buffeting the traditional advisory business.

Index mutual funds and passively managed ETFs, which track broad and narrow market indexes, are putting enormous pressure on active managers to justify their higher fees. Given the difficulty active managers face in consistently outperforming a benchmark over time, as well as the regulatory constraints and tax shortcomings of the open-end fund structure, more and more investors are opting for low-cost ETFs for their long-term holdings.



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The shift from active to passive management has been felt in the advisory business in the form of lower revenue from commissions and fees. The rise of robo-advice, passive management and other factors also is leading to the commoditization of investment management, where the individual advisor is becoming less able to add value through either investment or manager selection—and less able to charge a premium for doing so.

Demographics and regulation

The aging of the Baby Boomer generation, changes in the way retirement is funded, and regulation also have been driving forces in making financial planning more central to the advice business.

Baby Boomers now account for half of the industry's AUM, according to a recent report by the PriceMetrix unit of McKinsey & Company. The report also notes that clients born before 1945 account for 40 percent of assets while members of Generation X (1966–1980) represent 8 percent of assets and Millennials just 2 percent of the money managed by full-service firms.

The demographic challenge to advisors is clear: Continue to attract and retain Baby Boomer clients as they navigate retirement and spend down assets, while at the same time build for the future by attracting younger investors who are entering peak earning and saving years.

Looming over both older and younger investors is the need to save for retirement in a world where defined benefit pension plans have all but disappeared. Most investors today realize that they alone are responsible for their retirement income, and that while employer contributions to workplace plans and Social Security benefits are important, it will be their own savings in defined contribution plans and/or their Individual Retirement Accounts that will carry them through retirement. While still subject to the irrationality that the growing discipline of behavioral finance has illuminated, investors who have absorbed the implications of this shift in retirement responsibility tend to become concerned less with short-term stock market performance and more interested in making sure that their nest egg not only grows but is also secure and adequate.

The change in retirement funding that is making financial planning central to individuals' approach to investing is mirrored in regulation, particularly the Department of Labor rule establishing a fiduciary standard for retirement advice. The ultimate rule may differ from what now is in effect, but its guiding force has been the recognition that with individuals now responsible for building an adequate retirement nest egg, there is a public policy interest in making sure that those savings pools are handled and managed with the greatest care possible. If investment advice around those retirement savings pools is to be provided in a fiduciary context with a long-term goal in mind, advisors must make ongoing investment decisions in the context of an overall plan.

The need for advisors to provide sophisticated financial planning, therefore, has never been greater.

THE GROWTH OF FINANCIAL PLANNING SOFTWARE USAGE

Among advisors, financial planning software is right behind customer relationship management (CRM) software in popularity, with 82 percent of firms currently using a financial planning product (compared to 90 percent using CRM software), according to the 2017 InvestmentNews Advisor Technology Survey. That is up from a usage rate of 76 percent in the 2013 survey.

The survey found that 84 percent of advisory firms are expected to be using financial planning software by the end of 2017 as planning becomes more and more essential to the holistic advice clients are coming to expect from advisors. Planning software is used by firms of all sizes in all channels, although firms with revenue in excess of $15 million (where the average AUM per client is $385 million) tend to be the least active users since such firms typically create bespoke financial plans that reflect the complexity of the assets and tax and estate considerations of their clients.

Firm efficiency and profitability are the major reasons for considering financial planning software and other technology tools, the study found. When asked for their top consideration when evaluating existing technology performance, advisors ranked as their first choice improving workflows to free up professionals' time (cited by 36 percent of advisors), followed by increased profitability/added value to the business (21 percent), productivity gains (17 percent), and effect on client experience (15 percent).

Advisors' forward-looking views were similar. When asked for their top consideration when deciding whether to invest in new technology, 30 percent of advisors cited whether the technology would improve workflows to free up professionals' time. That is up from just 3 percent in 2015. The second most important consideration was whether the new technology would increase profitability and add value to the business. That factor was cited by 23 percent of advisors, up from just 6 percent in 2015.

Clearly, more and more advisors view financial planning as a service that is central to their business and its success, and they view financial planning software as becoming essential to being able to deliver that service efficiently and profitably.

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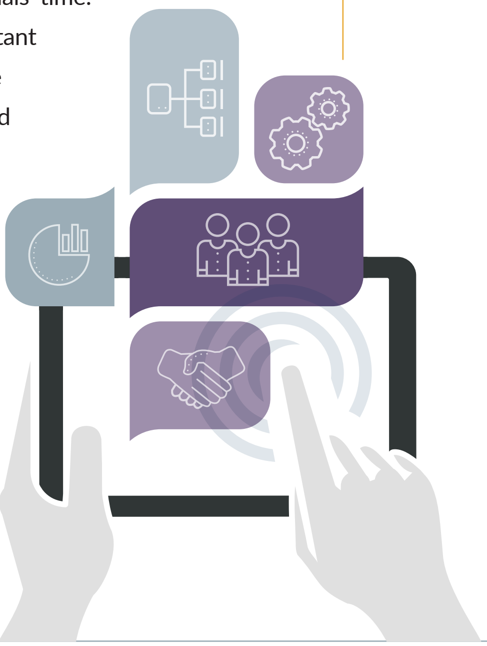


MAXIMIZING FINANCIAL PLANNING TECHNOLOGY

"Where am I? Am I on the right path to meet my goals? Is there anything I need to adjust?"

Those three questions are at the core of what most clients want to know about their financial lives, which makes delivering easy-to-understand, attractive, and accessible information an important feature of the best financial planning technology. Maximizing the technology's potential involves encouraging clients to employ its account aggregation features and then making the most of its ability to support client-advisor collaboration and ongoing communication.

Seeing a client's entire financial picture—including all investments held everywhere; checking and savings accounts; CDs; credit card accounts; and other non-investment-related financial accounts such as student loans and mortgages—is necessary for an advisor to assess a client's financial health. In fact, most advisors consider the use of account aggregation software as the required first step in creating any financial plan that is ongoing and part of a long-term relationship.

Of the many technology products advisors use, account aggregation software—currently deployed by 66 percent of firms, up from 53 percent in 2013—will get the biggest boost in 2017, with another 7.3 percent of firms planning to add it, according to the most recent InvestmentNews Advisor Technology Study. As advisors increase their focus on providing holistic advice, account aggregation software—with its ability to provide a broad picture of a client's total finances—has gained market share.

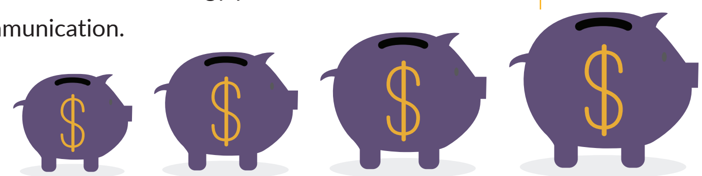
Among advisors surveyed, 45 percent believe that account aggregation is among the most important features of a client portal, second only to portfolio performance reporting, which was cited by 66 percent of advisors. Account aggregation software serves the needs of clients who perceive value in the ability to see their full financial picture in one place. It also can reduce compliance problems by enabling advisors to view client assets without needing to know or retain client usernames and passwords, which can trigger custodial requirements.

66%

of advisors say that portfolio performance reporting is the most important feature of a client portal.

While many clients may not mind the somewhat tedious and time-consuming job of inputting the initial data that account aggregation software requires, other clients will find it confusing and burdensome. A best practice for advisors or a junior staff member, therefore, is to manage and perform much of the inputting. Just as annoying as wading through shoeboxes full of receipts is to accountants who need the paperwork in order to do a client's tax return, going through a client's credit card accounts is no financial advisor's idea of time well spent. After this one-time chore is done, however, an advisor will reap great rewards in higher productivity, time efficiency, and client satisfaction in using a technology tool that enhances their sense of control over their future.

Another advantage of today's dynamic financial planning software over those that produced static documents in the past is that current technology permits online client-advisor collaboration and communication.



Because clients now can log in to their account and use the software to see where they stand, modern financial planning tools can support the client-advisor interaction in a way that not only helps answer questions about meeting long-term financial and life objectives but also cements client relationships. Perhaps the most important feature of financial planning software to allay client fears and underscore the value of the advisory relationship is its "what-if" capabilities, which can illustrate outcomes under various scenarios.

One best practice in this area is to take some possible events, especially unpleasant or feared ones—a sharp market correction, a sudden illness that boosts healthcare spending, or a forced early retirement, for example—and use the software to illustrate the likely impact on a client's portfolio should such an event occur. Of course, no one likes to focus on unpleasant events that may never happen. Most clients, however, find that "pre-experiencing" a negative event eases their concerns by either showing that the impact would be less dire than expected or by prompting a conversation with their advisor about the steps that can be taken now to mitigate the impact of an unexpected shock.

More positively, advisors can collaborate to show the impressive long-term effects of changing current savings and consumption patterns. Given the human tendency noted by behavioral finance experts to overweight rewards in the present and underweight pain and losses in the future, many people find it difficult to divert current spending into savings. Using financial planning software collaboratively enables advisors to show in a visceral way how regular savings of even a small amount today can add up to sizeable sums in the future. (Use the "latte" example: A young client who commits to saving $20 a week—the equivalent of what they might be spending on a daily premium coffee—could easily accumulate an extra $300,000 or more in savings over the course of their working years).

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TECHNOLOGY: THE KEY TO SCALABILITY

Data from the most recent InvestmentNews Financial Performance Study demonstrates that while firms remain profitable and revenues are at all-time highs, growth rates are contracting and fee compression is taking hold; typical revenue yields are at five-year lows.

As greater competition puts pressure on fees and margins, the traditional formula for growth and profitability in the advisory business—adding more advisors to gain more AUM—no longer yields the results of the past. For individual advisors, it is a similar tale: Adding more clients to make up for declining revenue per client only speeds up the workplace treadmill and threatens the delivery of quality customer service.

Advisory firms ranging in size from solo practitioners to large national organizations have learned that profitability and the ability of the business to scale into a viable enterprise with equity value must come from greater advisor productivity, and that can only come from redesigned workflows that are systematized and automated so that advisors can concentrate on higher-level tasks.

36%

of advisors say that the top factor when investing in technology is to improve workflows–the #1 overall technology consideration.

As noted earlier, when asked for their top consideration when evaluating existing technology performance, advisors ranked as their first choice improving workflows to free up professionals' time (cited by 36 percent of advisors), followed by increased profitability/added value to the business (21 percent), productivity gains (17 percent), and effect on client experience (15 percent).

As we have seen, the future of the advisory business increasingly depends on being able to deliver comprehensive financial planning in ways that mesh with client preferences. For that to be done in a way that enables advisors to serve a greater number of clients with a high level of service, the use of sophisticated financial planning software is imperative.