ADVISOR INSIGHTS

The value of advice

How to identify, quantify, and communicate your value to clients

Downward pressure on fees is one of the biggest challenges facing financial advisors today. Increased competition, the race to zero on trading costs, and the emergence of digital (or "robo") advice platforms have converged to flood the market with inexpensive options, and prompted many advisors to consider whether they need to defend, justify, or even reduce their fees.

The current market volatility, where short-term returns may be negative, has also put a spotlight on the expenses associated with professional investment guidance. These developments have resulted in a need to clarify what constitutes value for clients and how much they should pay for advisory support. Overcoming this challenge requires understanding the value you bring to client relationships and communicating this value effectively.

Now more than ever, it's critical that independent financial advisors demonstrate the value they bring to client relationships. Many clients today want to know exactly what they're getting in exchange for the advisory fees they pay.

COMMUNICATING VALUE TO YOUR CLIENTS

How much are the average fees advisors are charging? According to AdvisoryHQ, the average annual advisory fee charged by fee-based financial advisors is 1.02% of assets under management for accounts with $1 million or less in assets. The average fee is slightly higher for accounts with $100,000 or less in assets (1.12%) and marginally lower for accounts with up to $5 million in assets (.84%).[1]

The question is: Do clients really understand the value of all the services provided by their financial advisor for the fees they are paying? It's up to advisors to clearly communicate this value in a way that clients can understand.

Unfortunately, most independent financial advisors tend to promote the same generic attributes when it comes to communicating their value to clients. In a poll conducted by *InvestmentNews*, more than three-quarters of financial advisors said that their main value proposition is "their ability to understand client needs and objectives."[2]

There's nothing inspiring, unique, or noteworthy about this bland value proposition. And if three-quarters of advisors are all saying the same thing, there's not much differentiation being communicated to prospects to help them understand the value of one advisory alternative over another. Many clients today want more specifics when it comes to understanding what kind of value they're receiving in exchange for their advisory fees.

RESEARCH QUANTIFIES THE VALUE OF AN ADVISOR

The good news is that research has been conducted that assigns an objective value to working with an independent financial advisor. According to the Vanguard study "Putting a Value on Your Value,"[3] receiving professional investment advice from an independent financial advisor can result in a net portfolio return that's more than 3% higher than do-it-yourself financial and investment planning over the long term.

To determine the 3% portfolio advantage, the researchers analyzed three of the most common dimensions of value offered by independent financial advisors and calculated the average additional portfolio return generated by working with an advisor:

- **Portfolio management: Investment outcomes.** This dimension involves helping clients achieve optimal portfolio construction, including the proper asset allocation and asset location while assuming the appropriate level of portfolio risk. Asset allocation is an especially critical component of value since research has demonstrated that it plays such a big role in portfolio returns.

According to modern portfolio theory that goes back to Harry Markowitz's landmark research in 1952, more than 90% of an investment portfolio's long-term return is driven by asset allocation and proper diversification, rather than the selection of individual assets or securities.[4]

Professional advice in this area led to "meaningful outcomes" for most investors and resulted in an average additional return for clients of up to 1.2%.[5] According to the follow-up Vanguard study "Assessing the Value of Advice," this advice materially altered equity risk-taking for two-thirds of clients,

reduced cash holdings for about three out of 10 clients, and eliminated home bias (or the tendency to invest the majority of a portfolio in domestic stocks while neglecting international stocks) for more than nine out of 10 clients.[6]

- **Wealth management: Financial outcomes.** This dimension involves helping clients attain a wide range of financial goals related to saving, spending, managing debt, and planning for retirement, including portfolio rebalancing and draw-down strategies. Financial portfolios don't exist in a vacuum; rather, they should be integrated with all other components of a client's overall financial and wealth picture.

  Professional advice in this area resulted in an average additional return for clients of up to 1%.[7] When the Vanguard researchers calculated the forecast success rates of a sample of clients, they determined that eight out of 10 have an 80% or greater probability of achieving a secure retirement.[8]

- **Behavioral coaching: Emotional outcomes.** This dimension involves helping clients achieve financial peace of mind and a sense of well-being by steering them away from making emotional investing decisions that result in panic selling. This guidance is designed to help clients stick with a well-thought-out, long-term investing strategy. Put simply, the value of advice can't be measured just by quantitative factors. There's also a qualitative aspect to it that's more subjective and is based on the client's emotional relationship with his or her financial advisor.

  There are several elements to this emotional connection between clients and their financial advisors. These include trust in the advisor, a sense of confidence on the part of the client, the client's perception of financial success or accomplishment, and the nature of behavioral coaching itself (for example, calming a client during times of market volatility).

  According to the Vanguard study, professional advice in this area results in an average additional return for clients of up to 1.5%.[9] Emotional outcomes account for nearly half (45%) of the total value that clients perceive from their relationship with a financial advisor. The remaining 55% of perceived value is associated with the more functional aspects of the advisor-client relationship like those detailed above.[10]

Potential value added for clients by professional guidance

Activity	Potential basis points of value
Suitable asset allocation using broadly diversified funds/ETFs	> 0*
Cost-effective implementation (expense ratios)	34
Rebalancing	26
Behavioral investing	150
Asset location	0-75
Spending strategy (withdrawal order)	0-110
Total return vs. income investing	>0*
Total potential value added	**About 3% in net returns**

Value is significant but too unique to each investor to quantify.

Source: *Vanguard, Putting a Value on Your Value,* Quantifying Vanguard Advisor's Alpha, Feb. 2019.

MORE AREAS WHERE VALUE CAN BE ADDED

Independent financial advisors can add value to client relationships beyond these three core dimensions. For example, advisors can help clients implement wealth protection strategies to safeguard their assets from loss, as well as estate planning strategies to ensure the continuation of their legacy and tax avoidance strategies to minimize investment and other taxes.

The independence offered by a registered investment advisor (RIA) also adds qualitative value to client relationships. Clients need to understand the value of this independence and the value of the fiduciary standard that you provide. As an RIA, your fiduciary standard includes both:

- **A duty of care**—which requires you to offer clients advice that's in their best interest, seek the best execution of the client's transactions, and provide advice and monitoring over the course of the client relationship, and
- **A duty of loyalty**—which requires you to not place your own interests above your clients' interests. For example, you must expose any conflicts of interest that might incline you, either consciously or unconsciously, to offer advice that's not disinterested

enough for the client to be able to make an informed decision about whether or not to consent to the conflict.

You can share with clients that existing common law fiduciary obligations require you to avoid conflicts of interest as much as possible while disclosing any conflicts you can't avoid. And that you must either eliminate or at least expose through full and fair disclosure all conflicts of interests that might incline you consciously or unconsciously to render advice that is not disinterested.

HOW TO COMMUNICATE YOUR VALUE TO CLIENTS

It's important to communicate the value of your advice and services to your clients in a consistent and effective way. Here are five ideas to consider:

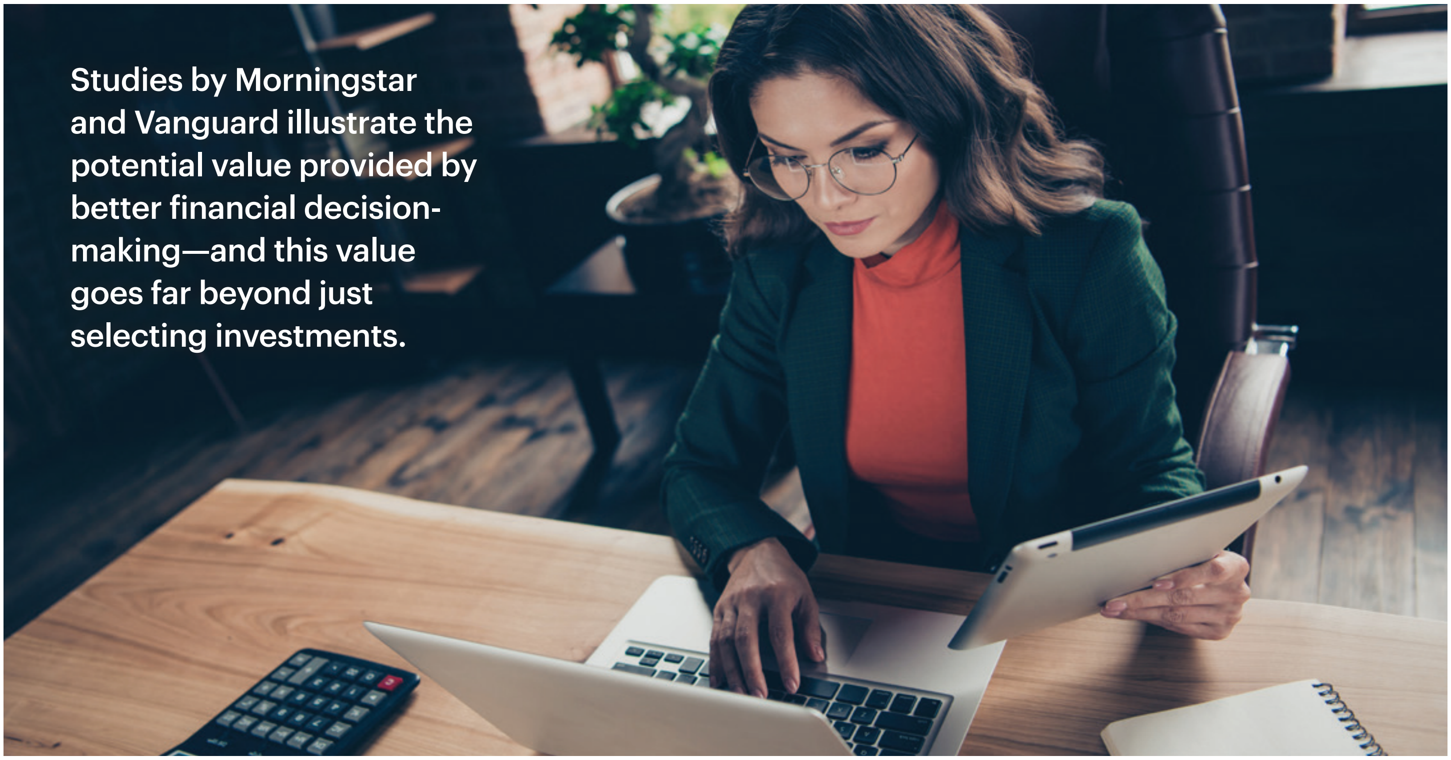
1. Publish an e-newsletter. Your e-newsletter can include links to helpful articles and videos that explain to clients the value of your advice with regard to all aspects of financial planning and investing. This includes portfolio diversification, asset allocation, risk management, retirement planning, and managing debt.

2. Create a blog. Blogs are a great way to communicate urgent and breaking news to your clients such as new legislation affecting their finances (like tax reform) and major developments affecting their investments, such as the COVID-19 pandemic. This gives clients a hands-on example of the real-world value of your financial and investment advice. You blog can be hosted from your website.

3. Produce a podcast. Audio and video podcasts enable you to share your value proposition and the value of your advice with hundreds or even thousands of viewers or listeners all at the same time. Doing so can help you build your name recognition and personal brand as a trusted independent advisor, which may help you strengthen existing relationships while also attracting new clients.

4. Use social media effectively. With more investors today seeking financial and investing information on social media, this has become a useful tool for sharing the value of your advice with clients and prospects. For example, in a study conducted by Sysomos and Marketwired, four out of 10 investors said that social media is a key source of investment information for them.[11] And about half of investment advisors are now using social media as a communication tool.

5. Create educational materials. Producing a brochure or flyer explaining the services and support clients receive for their fee-based account as well as detailing your unique value proposition can be an effective way



What services do you deliver for your advisory fee?

To help clients and prospects appreciate the value of the services they receive as part of their fee-based accounts, consider including a description of your services and their benefits in your marketing materials and on your website. Your services and support may differ, but here's an example of a list of services a typical independent financial advisor may provide:

- Development of an integrated, personalized investment program based on the client's financial goals.
- Portfolio construction, including appropriate allocation of funds among multiple asset classes.
- Active management of the portfolio, providing access to best-in-class institutional money managers.
- Ongoing performance analysis and money manager review and due diligence.
- An advanced asset management process leveraging institutional techniques, authoritative research, analysis and insights.
- Broad diversification of the portfolio across multiple asset classes, investment styles and money managers.
- Ongoing monitoring and adjusting of the portfolio to ensure that investments remain aligned with the client's financial goals and preferences.
- Regular rebalancing to maintain the proper allocations as outlined in the client's written Investment Policy Statement.
- Tailored tax management including automatic tax harvesting for taxable portfolios.
- Regular, detailed reporting on the portfolio's activity and performance.

to communicate the value of your advice to your clients and prospects. When professionally written and produced, these kinds of materials can reinforce your value as an independent financial advisor.

UNDERSTANDING AND COMMUNICATING VALUE IS CRITICAL

In an environment where more and more clients are demanding to know how much value they're getting in exchange for the advisory fees they're paying, financial advisors must be able to explain the value they bring to client relationships and communicate this value effectively. Consider how you can implement some of these strategies to share your value proposition with your clients and prospects.

---

[1] "What Are the Average Financial Advisor Fees & Investment Fees Being Charged in 2020?" AdvisoryHQ. https://www.advisoryhq.com/articles/financial-advisor-fees-wealth-managers-planners-and-fee-only-advisors/#Percentage-AUM)

[2] Liz Skinner, "For Financial Advisers, Communicating Value Starts with Knowing What's Valued," InvestmentNews, February 24, 2016. https://www.investmentnews.com/for-financial-advisers-communicating-value-starts-first-with-knowing-whats-valued-66556

[3] Francis M. Kinniry Jr., et al, "Putting a Value On Your Value: Quantifying Vanguard Advisor's Alpha," Vanguard, February 2019. https://www.vanguard.com/pdf/ISGQVAA.pdf

[4] David Larrabee, CFA, "Setting the Record Straight on Asset Allocation," CFA Institute, February 16, 2012. https://blogs.cfainstitute.org/investor/2012/02/16/setting-the-record-straight-on-asset-allocation/

[5] Francis M. Kinniry Jr., et al, "Putting a Value On Your Value: Quantifying Vanguard Advisor's Alpha," Vanguard, February 2019. https://advisors.vanguard.com/iwe/pdf/ISGQVAA.pdf

[6] Ibid.

[7] Ibid.

[8] Cynthia A. Pagliaro and Stephen P. Utkus, "Assessing the Value of Advice," Vanguard, September 2019. https://www.vanguard.com/pdf/assessing-value-advice.pdf

[9] Francis M. Kinniry Jr., et al, "Putting a Value On Your Value: Quantifying Vanguard Advisor's Alpha," Vanguard, February 2019. https://www.vanguard.com/pdf/ISGQVAA.pdf

[10] Cynthia A. Pagliaro and Stephen P. Utkus, "Assessing the Value of Advice," Vanguard, September 2019. https://personal.vanguard.com/pdf/assessing-value-advice.pdf

[11] "The Future of Investing and the Great Social Shift," Sysomos, May 9, 2013. https://blog.sysomos.com/2013/05/09/the-future-of-investing-and-the-great-social-shift-infographic/