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Is E-Wholesaling The Missing Link in Consulting Support?

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For the first time since 1981, we are in a domestic equity environment which will not be favorable to growing financial services assets. Skilled investors such as Warren Buffet believe the extraordinary returns of the immediate past are not sustainable, and we will go through a prolonged period where there will be a reversal to historical mean returns. By extension, forecast returns for the foreseeable future are not expected to break double digits and are likely to be closer to the 3% anticipated growth rate in gross domestic product than the 15% returns investors have come to expect. In the highly competitive asset management business which is not accustomed to capital redemptions and net capital outflows, it has not gone unnoticed that investment management consultants are not only continuing to grow their assets at a healthy 20% 30% clip, but in a down market, it is actually far easier for consultants to win business than when the market is trending up. Leading money management firms are beginning to discover if you can't sell performance and you are compensated by asset growth, you must sell process.

Faced with the prospect of a shrinking asset base, money managers see investment management consulting as a vehicle they can use to aggressively grow their asset base. By embracing the process and technology of advice necessary to add value, these firms will use their marketing resources to foster the industry's evolution towards advice and in the process, aggressively grow their asset base. This next generation of web-based e-wholesaling, built around the process and technology of adding value is the missing link in consulting support. Leading asset management firms will find it economically viable to provide advisors access to the process and technology infrastructure necessary in order for the advisor to provide high level, comprehensive, expert advice. In doing so, leading asset management firms elevate the financial services industry by providing world-class, differentiating tools essential for all financial advisors to add value.

> **LEADING MONEY MANAGEMENT FIRMS ARE BEGINNING TO DISCOVER IF YOU CAN'T SELL PERFORMANCE AND YOU ARE COMPENSATED BY ASSET GROWTH, YOU MUST SELL PROCESS**

It is in the enlightening self-interest of the leading money management firms to devote their considerable resources in growing the market for high level advice. There is a direct correlation between the level of professional investment and administrative counsel the financial adviser provides and the rate at which the advisor grows their asset base. Thus, the higher the level of advice provided, the faster money managers can grow their business. By extension, enterprising asset management firms are changing the rules of competition and reordering the financial services industry by simply providing the tools necessary to facilitate high level, comprehensive, expert advise. Investors prefer value to be added and will not accept anything less. Thus, the next generation of asset management firms will seize market leadership and will win dominant marketshare around empowering the financial adviser to compete on the basis of the depth and breadth of the investment and in net administrative values they address and manage. They will arm their wholesale talent with the intellectual property and tools which will allow them to reshape the course of the financial services industry, one advisor at a time.

The biggest challenge the financial advisor faces today in building a top consulting practice is the limited technical and support resources available in providing world-class investment and administrative counsel for their clients. Each consultant has had to find their own way in developing their own process, technology and methodology in addressing a broad range of investment and administrative values as required under UPIA (for individuals), ERISA (pension plans) and MPERS (public funds). Through the sheer will and initiative of pioneering consultants, today the six financial service investment process (assets study, investment policy, strategic asset allocation, manager search and selection, performance monitor and tactical asset allocation) has become standard methodology through which value is added. Yet, because this six

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financial service investment process requires a uniquely specific application in addressing the needs of each of the ten major market segments of the individual (mass, retail, high net worth, ultra high in net worth) and institutional (defined contribution, foundation and endowment, defined benefit, profit sharing, public funds and Taft Hartley) markets, the six financial services investment process has become an art form which has limited its application. Though intellectually, many advisors understand in principle high level advice, without institutionalized support providing the processes and technology necessary to add value, high level advice for each market segment is, in fact, an art form. The next generation of web-based e-wholesaling institutionalizes the key processes and technology of adding value so it becomes more of a science than an art form and empowers a far larger number of advisors to address and manage a broad range of investment and administrative values. The financial advisor no longer has to reinvent the wheel every step along the way and is empowered to add far more value, advise far more assets and make far more money than they ever dreamed of.

There are several tools, which are essential to adding value, which are a heavy burden on consultants if the consultant has to create them on their own. Yet, the automation of these tools into an easy-to-use technology is neither expensive nor does it require extraordinary intellect. Thus, by enterprising management organizations spending relatively modest sums of money to develop these tools, they gain an extraordinary competitive edge in empowering the financial advisor to add value. They become the difference between an advisor adding value and not. For the money manager, this is the ultimate in market differentiation, the ultimate in advisor empowerment and the ultimate in market leadership that translates into significant asset growth.

There is the tendency to speak of adding value in the abstract, but adding value (under regulatory mandate) requires very specific values to be addressed and managed in a highly tangible and quantifiable manner. There are seven tools that would greatly reduce the effort required for the advisor to addressed and manage the broad range of investment and administrative values necessary in order for value to be added. These seven tools are the missing link in consultant support. They are: (1) the electronic asset and liability study, (2) estate planning optimization, (3) electronic policy statement, (4) electronic portfolio management (subaccounting, trade and order routing and reporting), (5) electronic performance monitor, (6) electronic investment methodology and (7) web-based market segment support. These tools allow the consultant to leverage their time through process and technology, making it possible to provide high level advice to a large number of clients.

It should be noted that the next generation of e-wholesaling built around these seven tools goes far beyond today's e-wholesaling comprised of the literature line (e.g., prospectus, marketing materials), call desks (e.g., webcasts, PowerPoint presentations, e–mail communications, more timely and robust performance updates), sales desks (targeted customized sales support) or web-enhanced conventional wholesaling. E–wholesaling, as we know it today, is only good as its content, and its content is not compelling. Conventional e-wholesaling today is product-focused and self-serving with very light content, not designed to add value but geared to the mass market of retail investors who account for 90% of investors but only 10% of the assets. E-wholesaling provides speed and access to a mass market that does not require a high degree of sophistication in support of commission sales. The next generation of e–wholesaling is totally different. It is mission-critical to adding value, focused on the process and technology necessary to add value, geared to 10% of the investors that have 90% of the assets that require more discernment and far more sophistication. Thus, mass market e-wholesaling of today is a totally different mindset from the next generation of e-wholesaling where the wholesaler is empowered to deliver high value added, industry-redefining, intellectual property essential to adding value.

> **THE NEXT GENERATION OF WEB-BASED E-WHOLESALING INSTITUTIONALIZES THE KEY PROCESSES AND TECHNOLOGY OF ADDING VALUE SO IT BECOMES MORE OF A SCIENCE THAN AN ART FORM …**

The Electronic Asset and Liability Study

Though we all would like to think for the good of the industry that every financial advisor is adding value, in order for it to be possible for the financial adviser to add value, each investment recommendation must be evaluated in the context of all the client's assets and liabilities. Only then can one determine if a recommendation improved overall portfolio returns, reduced risk, enhanced the tax efficiency, liquidity and cost structure of all the client's assets as a whole. In essence, without an electronic asset and liability study which can evaluate all of a client's assets and liabilities as an investment portfolio, it is not possible for a financial advisor to know if they are adding value. Consultants spend an immense amount of time tracking all the client's assets and liabilities custodied in-house and outside their firm in order to measure and evaluate portfolio performance and confirm or evolve investment policy, strategy and tactics. In recent years the back-breaking work of monitoring all an investor's assets and liabilities has been made easier by Yodlee (screen scraping) and Kineux (live custodial links) developing account aggregation technology which provides advisors with accurate and complete information on all their client's assets and liabilities. The electronic asset and liability study manages aggregated account information to determine the precise rate of return the investor has achieved on all their assets, the risk exposure they have assumed, the tax efficiency, cost structure and liquidity of all their assets and liabilities as an investment portfolio. Most clients do not have an understanding of fundamental considerations like the return being realized on all their assets or the risk exposure they are assuming, or their tax efficiency, cost structure or liquidity. By virtue of the financial advisor

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simply having access to an electronic asset and liability study, they have a superior value proposition to financial advisors who can neither opine to any of the value considerations (risk, return, tax efficiency, liquidity, cost structure, etc.), required under UPIA, ERISA or MPERS nor establish whether their recommendations actually added value. Without an electronic asset and liability study, advisors wouldn't know they were adding value, even if they are. Thus, the electronic asset study is a powerful sales tool that clearly delineates whether value is being added and differentiates the level of advice the financial advisor provides, allowing the advisor to literally win almost any account at will. The cost to develop the electronic asset study, which quantifies and reports on a broad range of values, is less than $1 million and puts into play virtually all assets which are not managed under a disciplined investment process or are not being held accountable for results. By causing a predictably unfavorable comparison of results, the vast majority of U.S. assets are not only put into play but a new generation of asset management leadership (managed account, folio and ETF managers) stands ready to provide investment solutions perfectly suited for fee-based portfolio construction. The benefit of managed account, folio and ETF companies spending just $1 million to change the rules of competition so that asset growth in their products is very favorable, far transcends its costs. (See "Is Account Aggregation and the Electronic Asset Study the Key to Taking High Level Advice into the Financial Services Mainstream?", *Senior Consultant,* September-October 2001.)

Estate Planning Optimization

Objective evaluation of client portfolios after estate planning has been executed often finds that in resolving estate tax issues, larger problems are created in the form of poor investment performance, extremely high portfolio cost structure and illiquidity, because a large portion of the client's assets are owned within an insurance contract. There is a bias within most estate planning software that commissionable insurance sales are always the preferred solution before non-investment procedural solutions, fully utilizing trusts, are considered. Novana™ Analytical Systems has created a state-of-the-art estate planning tool that optimizes the full range of estate planning options, including procedural and investment solutions that would allow advisors, without indepth personal expertise in estate planning, to determine an attractive range of solutions which minimizes estate tax liability while maximizing the performance and investment implications of estate planning. The client wins by achieving a far lower portfolio cost structure, greatly enhanced portfolio performance and liquidity. The allure of massive insurance commissions is no longer the driving motivation for advisors to do estate planning work, and the advisor wins by being able to better manage their estate planning support resources by directing those resources to work within a specific range of trust and insurance solutions.

WITHOUT AN ELECTRONIC ASSET AND LIABILITY STUDY, ADVISORS WOULDN'T KNOW THEY WERE ADDING VALUE, EVEN IF THEY ARE

Estate planning differentiates the highest level of professional investment and administrative counsel for individual investors. The ultimate high net worth market segmentation tool is estate tax minimization which differentiates advisors capable of serving the higher end of the high net worth market with assets in excess of $1.3 million. Because estate taxation defines high level advice at the higher end of the high net worth market where most of the assets of individual investors are, it would make great sense for a money manager to own the high net worth and ultra high net worth markets by spending $3 million to create a private-label application with Novana and give the technology away to advisors who want to provide world-class investment solutions while minimizing estate taxation for their high net worth clients. By not having access to such a comprehensive solution, advisors would be at a loss in competing for estate tax-efficient, high net worth solutions. Thus, Novana would become a magnet for the money manager in winning lucrative high margin, high net worth assets.

Electronic Policy Statement

The most important document in providing world-class professional investment and administrative counsel is a statement of investment policy. It defines the investor in very intricate terms:

- defines the client's goals and objectives,
- sets forth the investment and administrative values to be addressed and managed,
- defines investment strategy,
- establishes the role of the investor, the consultant and money manager, and
- provides the conditions under which managers are hired and fired.

This is the institutionalized corporate memory that drives the client relationship, that establishes a cohesive long-term investment focus that is perfectly aligned with each investor's needs, objectives and circumstances. A statement of investment policy with legal opinions stating that policy and the resulting investment strategy and portfolio are in compliance with ERISA, UPIA and/or MPERS is essential in providing the highest level of professional investment and administrative counsel. It is also essential in managing fiduciary responsibility and being in compliance with best practices. Thus, the question: How does the financial advisor find the time to spend hundreds of manhours to create custom statements of investment policy for each client?

Rowe Decision Analytics offers custom statements of investment policy for each of the ten major market segments of the individual and institutional markets with legal opinions stating that policy and strategy are in compliance with UPIA, ERISA and MPERS. With Rowe Decision Analytics, the advisor only spends time-customizing each policy statement which means 80% of the work is done as a starting point. Rowe Decision Analytics puts world-class policy in reach of all financial advisors. A smart money manager should package and give away the electronic asset/liability study and electronic policy statement which is 90% of what is required to win new client accounts built around high level, comprehensive, expert advice. This would be easy to execute, it would redefine the industry, buy unlimited shelf space for the money manager and would allow separate account,

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folio and ETF managers who are ideally suited for more sophisticated forms of portfolio construction to grow their asset base 10-20 times over the next five years.

Electronic Portfolio Management Technology

One of the keys to Charles Schwab aggressively growing their institutional business which serves advisors and money managers is their acquisition of Performance Technologies which developed Centerpiece, a portfolio management technology. By Schwab buying Centerpiece and giving away subaccounting, trade and order routing, and reporting technology which is essential for one providing high level advisory services to a large number of clients, Schwab became an important strategic partner with its advisors in providing the necessary technological resources to build and operate an advisory services practice whether engaged in money management or investment management consulting.

There are dozens of subaccounting, trade and order routing, and reporting technology companies such as Advent and CheckFree Investment Services, which provide portfolio management services. A new generation of far more robust, web-based technology is emerging which is not only faster, better and one-tenth the cost but is built to resolve practical business applications for money managers and consultants, which makes old technology obsolete. Enterprising money managers should take a page out of the Schwab playbook and capture the lion's share of the advisor's asset base by providing the core technology and enhancements that make it possible for advisors to provide advice. Because the economics of asset management are far greater than a commodity technology application, the money manager would have the economic incentive to always push that envelope in technology development because the more value they can empower the consultant to add, the better their competitive position and the more assets they raise. Today, technology vendors have no vested interest in spending capital for process enhancement which has stagnated the industry's development and evolution. Money managers bring a more economic motivation to invest in technological innovation because through technology they differentiate themselves and build marketshare and their asset base.

> THUS, TO ASSURE THE FINANCIAL ADVISOR THEY CAN AT LEAST DELIVER A MARKET NEUTRAL STRATEGY THAT WOULD APPROXIMATE THE APPROPRIATE INDEX-BASED CLIENT OBJECTIVE, INNOVATIVE SEPARATE ACCOUNT, FOLIO AND ETF MANAGERS WOULD BE WISE TO OFFER AN INVESTMENT METHODOLOGY THAT WOULD ACCOMPANY THEIR INVESTMENT PRODUCTS

Electronic Performance Monitor

The capturing and downloading of of all client account information and evaluating it in terms specifically meaningful to each client represents the most profound opportunity for technological innovation. Massive marketshare can be won (ala Schwab) by resolving the technological challenges of performance reporting. Because the intellectual property required is not particularly challenging and because of breakthroughs in subaccounting, trade and order routing dramatically reduce cost and commoditize functionality, the electronic performance monitor can be developed very inexpensively but represents huge value added for the advisor and their clients in the depth and breadth of values addressed and managed. Access to the electronic performance monitor will reduce the labor intensity of consulting and facilitates far more advisors providing a far greater level of counsel and accountability than is the case today. Again, by growing the advice market, the separate account, folio and ETF manager can also grow their asset base.

Investment Methodology

The process and technology of investment management consulting that facilitates high level advice, only makes it possible for the consultant to address and manage a broad range of investment and administrative values. How good the consultant is at adding value is a function of the investment methodology they use. Money managers manage assets in accordance to an investment mandate characterized by a specific investment management style (value/growth/cap size), but ultimately the portfolio performance of each investor is determined by the advisor establishing what configuration of management styles are required in order for the client to achieve their objectives. Market neutral investment methodology designed to achieve index type returns are often used by institutional consulting firms like SEI or Frank Russell to approximate a custom composite index of aggregated management styles appropriate for each investor. Thus, to assure the financial advisor they can at least deliver a market neutral strategy that would approximate the appropriate index-based client objective, innovative separate account, folio and ETF managers would be wise to offer an investment methodology that would accompany their investment products. This would allow market neutral strategies to be developed with separate accounts, folios and ETFs that would establish a base point threshold for more sophisticated portfolio construction. In a simple paint-by-the-numbers methodology, advisors would simply plug-in, for example, large cap value as the investment methodology would suggest. This alleviates any lack of confidence that financial advisors may not be adept at portfolio construction by entering the marketplace at a sophistication level comparable to the advice that SEI and Frank Russell manufacture for institutional clients. This would put the separate account, folio and ETF managers in the light of offering comprehensive advice, even though they do not specifically manage all the client's assets, they empower the advisor to build a market neutral or client-specific strategy around their products where appropriate, that assures the success of both the advisor and money manager. None of this is rocket science. By going the extra mile and giving the financial advisor a template to achieve any well-reasoned client objective, the money managers business is greatly impacted. By the money manager aligning their interests with that of the financial advisor, they both are positioned for extraordinary asset growth. The capital required to create such an investment methodology function is relatively insignificant, but it will only work if adding value and a more disciplined form of portfolio construction is the driving and defining strategy of the money management firm and its wholesale support.

Market Segment Support

Ninety percent of the investors are in the mass and retail markets, but 90% of the assets are in the high net worth and institutional markets where 10% of investors have at least $100,000 to invest and fee-based advice is economically viable. Specialized skills are required to serve the high net worth, ultra high net worth, defined contribution, foundation and endowment, defined benefit, public funds, profit sharing and Taft Hartley markets. Estate tax efficiency is the defining skill set necessary to serve the high net worth market, call centers are important in providing personalized advice to thousands of 401(k) plan participants, etc. Thus, enterprising money managers who want to aggressively grow their asset base should focus their support services on web-based services that would translate into high net worth and institutional business. Support in those areas is so thin that it is easy to differentiate oneself on the basis of the high level advice the money manager would support in each market segment. In the defined contribution market, there is an extraordinary opportunity for money managers to use web-based technology to win marketshare and to differentiate the level of service the financial advisor provides. Because this is true in every market segment, a new generation of value added, web-based tools designed to elevate the level of advice provided in the high net worth and institutional markets will transform wholesaling and shift its focus to where the assets are and where the most growth in asset base can be achieved.

The Opportunity

Today's e-wholesaling facilitates speed and access of product information in support of conventional commission sales for the mass market, that accounts for 90% of investors but only 10% of the assets. This is not the missing link in consulting support. But e-wholesaling sets the stage for the next generation of web-based initiatives which are geared to the 10% of investors who have 90% of the assets that require a higher level of professional investment and administrative counsel. Through the development of web-based consulting tools that greatly reduce the labor intensity of high level, comprehensive, expert advice, the financial and intellectual capital barriers to entry for financial advisors to provide high level advice will be removed. Given investors prefer value to be added than not, these web-based consulting tools redefine the financial services industry by simply making it possible, via free web-access, for the financial advisor to add value. Enterprising separate account, folio and ETF managers whose products are ideally suited for adding value through a more sophisticated form of portfolio construction, have a vested interest in creating these web-based consulting tools and growing the market for advice. Because investors prefer value to be added, these consulting tools that democratize high level advice will reorder the financial services industry around advice. Most financial advisors today do not have the tools to know whether their investment recommendations actually add value, thus an electronic asset study and policy statement not only elevates the level of advice the client receives, as does estate planning optimization, electronic portfolio management, electronic performance monitor, investment methodology and market segment support, but are essential to adding value. The separate account, folio and ETF managers who create these tools will provide the next generation of market leadership within the asset management business and, in return, will be the beneficiaries of massive asset flows drawn to the thesis of adding value. These consulting tools that align the interests of the investor, the financial advisor, the money manager and the industry in serving the best interest of the investor, elevate the financial advisor, their stewardship and their good advice and counsel. These tools redefine the financial services industry and reorder it around high level, comprehensive, expert advice. These leading asset management firms and the tools they create are the missing link in consultant support. ■

About the Author

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