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The Voice of the Investment Management Consultant

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Schwab To Announce Advisor-Branded Web Services, The Next Generation of Advisor Support

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The conundrum which continues to impede the thesis of adding value emerging as the driving force of the financial services industry is financial services firms encourage the financial advisor to add value through the engagement of their professional investment and administrative counsel for an on-going fee but do so only if the firm itself does not have to materially change its infrastructure to facilitate high level, comprehensive, expert advice. No one is against the notion of adding value, they are just against the idea of having to change so it is possible for the financial advisor to add value.

So, value is added only because the financial advisor takes the initiative to create the processes and technology necessary to address and manage a broad range of investment and administrative values, as required under the regulatory mandate of UPIA, ERISA and MPERS. This is a heavy burden for the advisor to bear on their own, and the resulting labor intensity of providing high level, comprehensive, expert counsel is daunting. It has been unfairly suggested by many in the institutional investment management consulting community that adding value is not likely to be successfully executed within a commission brokerage environment because of the radical changes in the culture, structure and technology required in order for it to even possible for the commission broker to add value. They dismiss or are not aware of the extraordinary work of thousands of pioneering financial advisors who have taken the personal initiative and are now providing high level advice. But they are correct in their assessment that the order of magnitude of the organizational changes required to alleviate the heavy intellectual and administrative burden borne by the financial advisor in adding value is beyond the comfort zone of most brokerage firms, unless it is a mandate from the very top of the organization. The loss of money, power and status of middle and senior management, which would result in reengineering commission brokerage firms around the process and technology of adding value makes it a difficult topic to even broach in an open forum. Yet, adding value is clearly the right thing to do, and the increasing transparency of account performance brought by the internet makes it a strategic imperative. Clearly, the investor prefers value to be added than not. Clearly, there is a definitive process and technology required in order to add value. So what will it take for the industry to embrace the notion of adding value and bear the pain to create and evolve the culture, structure and technology necessary for the financial advisor to add value? How about a little competition?

NO ONE IS AGAINST THE NOTION OF ADDING VALUE, THEY [THE FIRM] ARE JUST AGAINST THE IDEA OF HAVING TO CHANGE SO IT IS POSSIBLE FOR THE FINANCIAL ADVISOR TO ADD VALUE

Charles Schwab has changed the course of the financial services industry and is about to do it again. It championed the mutual fund supermarket which has been the catalyst for the emergence of fee-based advice within the financial services mainstream and effectively commoditizing financial product access. It championed internet brokerage which commoditized trade execution and shifted the balance of power from trade execution to adding value through fee-based advice. Today, the vast majority of the assets at Schwab are advised by advisors who engage their professional investment and administrative counsel for an on-going advisory fee. And now Schwab is substantially broadening its market by creating advisor-branded web services designed to remove the administrative and resource burden of the financial advisor who wishes to add value. It is not only the right thing to do, but there is a convergence of market forces that has created massive pent-up demand for any organization that is sympathetic to alleviating the tremendous resource and administrative burden personally assumed by the financial advisor in adding value. In a move on par with its other groundbreaking innovations, Charles Schwab has created Schwab advisor-branded web services which will offer any web-based technology necessary in order for the financial advisor to add value. By leveraging the financial advisor through process and technology, the

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administrative and technological burden of adding value is removed, and Schwab greatly expands it market. It is finally possible for all financial advisors to add value, if they so choose, which infinitely expands the market for Schwab serves and differentiates Schwab relative to its full-service competitors who have a vested interest in the commission brokerage model. The barriers to entry in adding value have fallen. Financial advisors no longer find themselves having to spend $250,000 to hire and develop their own support staff, process and technology just to get into the business of providing world-class, comprehensive, expert advice. Schwab is providing much of those technological resources and is doing so in an environment where it is OK to ask what would be heretofore politically and culturally incorrect questions in other venues. It is OK to have a passion for addressing and managing a broad range of investment and administrative values, it is OK to add value. For all financial advisors who have already assumed the personal initiative and expended the resources to add value; it is equally important that Schwab offers a home and an environment in which a world-class advisory services practice can be built and thrive. In fact, Schwab may well be your most enthusiastic supporter.

Schwab has taken a sure bet. It is simply betting that investors prefer value to be added than not. But the bet is more profound than that because of it has far reaching implications for the financial services firm, the financial advisor and the investor.

Schwab is betting that the major financial services firms on Wall Street will not be able to respond in-kind. Schwab reasons the loss of money, power and status of middle and senior management in the product management/commission brokerage bureaucracy will be too much to bear for a major commission brokerage firm to adapt to their culture, structure and technology around the process and technology of adding value. If a major financial services firm responds by creating a parallel support infrastructure for fee-based advice, it must reconcile with investors why commission brokers are not adding value. Schwab's advisor-branded web services forces large financial services firms to declare themselves. Either they are in the business of adding value or they are in the business of executing trades. If today's major financial services firms do not find a way to better manage their cost and better support world-class, comprehensive, expert advice, then Schwab plans to enthusiastically welcome advisors who would like to pursue that course.

The implications of Schwab's advisor-branded web services are profound for the advisor as well. Schwab understands and relishes the thought that the advisor is the value added; it is not simply gaining access through Schwab to financial products or trade execution. It is what the financial advisor does with the financial products, or process, that adds the value. Schwab wins marketshare by providing processes and technology which makes it possible to add value. Schwab also understands all sales and marketing is advisor-centric not firm-centric because each advisor's process and value proposition is unique. The web is a powerful vehicle for the advisor to articulate the depth and breadth of the investment and administrative values they address and manage, to discuss their investment process and investment methodology, to discuss current market conditions, to educate clients, to manage client information, data and communications and securely store important documents (tax returns, trusts documents, buy/sell agreements, investment policy, insurance contracts, etc.) as a trusted advisor should. Increasingly, investors will require financial advisors to be accountable for their investment recommendations because of the transparency of the internet. Thus, Schwab is defining itself to become invaluable to advisors who are adding value. This is significant for financial advisors because fee-based advice is only economically viable for those investors with more than $100,000 in liquid investable assets, and there are only enough households (15 million) with more than $100,000 to sustain 75,000 of today's 650,000 licensed financial services professionals, assuming each consultant can advise as many as 200 clients. Thus, Schwab has wisely created a built-in survival bias in its advisor-branded web services by highly valuing and primarily cultivating advisors who are focused on adding value through the engagement of their fee-based investment and management counsel.

SCHWAB UNDERSTANDS AND RELISHES THE THOUGHT THAT THE ADVISOR IS THE VALUE ADDED; IT IS NOT SIMPLY GAINING ACCESS THROUGH SCHWAB TO FINANCIAL PRODUCTS OR TRADE EXECUTION

With the market downturn, advisors are beginning to feel the impact of commission brokerage rates having declined 53% since 1991. The market has been so good for so long that almost no one has noticed the decline and commission brokerage rates. With Forrester Research have suggested that commission brokerage rates will decline another 60% over the next three years, it is in the enlightened best interests that successful financial advisors will move as aggressively as possible to build their practices around the engagement of their professional investment and administrative counsel for an on-going advisory fee. Schwab's positioning could not be any better. Where does the advisor turn for help? Who values and supports the thesis of adding value the most? Does the advisor's broker/dealer enthusiastically encourage progressive thinking and innovation? Schwab realizes wrap fee programs built around either mutual funds or managed account are old technology. By definition, it is not possible to add value in a wrap fee program, unless all the client's assets were in the mutual funds and/or the managed accounts wrap fee program. Because investors have 401(k) plans, defined benefit plans, assets held in insurance contracts or trust, savings accounts, stock, stock options, etc., it is not possible to add value by simply using wrap fee programs. This is not just because wrap fee programs cannot accommodate all the client's assets and liabilities, it is because the packaged investment process of a wrap fee program, by design, facilitates its sale

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as an investment product rather than accentuating the process and services through which value is added. A 7-question questionnaire and resulting client profile is no substitute for a customized statement of investment policy with a legal opinion that the associated investment strategy is in compliance with UPIA, ERISA or MPERS. There is no mechanism to serve a broad range of institutional clients with a one-size-fits-all wrap fee program. Without diagnostic tools like attribution analysis, how does the financial advisor evaluate each investment manager in each investor's portfolio against the investment mandate to which they were engaged to determine if performance is attributable to luck, skill or style. There is no overall investment strategy that incorporates all the client's assets. There is no quarterly review of the client's circumstance, market conditions, investment policy or investment strategy because the wrap fee program is promoted as a product sale, without much on-going client service. Thus, there is little or no on-going high level client dialogue to formally gauge and document the client's actual reaction to real market conditions as they unfold. There is no methodology for tactical portfolio adjustments to adapt policy and strategy. There is no mechanism for the advisor to create proprietary, privileged information that uniquely qualify the consultant to add value for the investor in ways no other advisor could. Only by providing high level on-going client service does the consultant literally become the value added. When one sells a wrap fee program, the client service is mechanical, and the advisor adds little value. The wrap fee program by design is a product. In order for the financial advisor to become the value added, the advisor must spend extensive time serving the client and the advisor's broker/dealer would have to redefine itself around supporting high level, comprehensive, expert advice. This is exactly what Schwab's advisor-branded web services is designed to do. Schwab's advisor-branded web services will provide financial advisors with web-based tools necessary for the advisor to become the value added.

From the client's perspective, world-class investment and administrative counsel is welcome. In commission brokerage, it is not possible to add value through a series of disjointed, unrelated transactions where no one is accountable for account performance. Through Schwab's advisor-branded web services, which include account aggregation technology, investors will finally be able to know the return being generated on all the client's assets and liabilities as an investment portfolio. They will know if they are taking 150% of the market's risk to get 50% of the market's return. They will know the cost structure of their investment portfolio and understand that mutual funds are 4-5 times more expensive than managed accounts, and folios and ETFs are 40% less expensive than a managed account. They will learn of the trade-offs between tax efficiency, liquidity, cost structure and investment performance. Clearly through process and technology, investors can make more informed investment decisions, and advisors can address and manage a broad range of investment and administrative values. The missing link is the web-based tools that make it possible to add value and the training and support that fosters advisors maximizing the utility of these tools.

THROUGH SCHWAB'S ADVISOR-BRANDED WEB SERVICES, WHICH INCLUDE ACCOUNT AGGREGATION TECHNOLOGY, INVESTORS WILL FINALLY BE ABLE TO KNOW THE RETURN BEING GENERATED ON ALL THE CLIENT'S ASSETS AND LIABILITIES AS AN INVESTMENT PORTFOLIO

Affluent investors are increasingly on-line and expect their advisors to have state-of-the-art web capabilities. Forrester Research has found half of all households having more than $1 million in investable assets spend 9.5 hours on-line per week on non-work related activities. Schwab advisor-branded web services will take the form of technology and web services for advisors to build, host and maintain a full-featured web site branded and customized for each advisor's practice. Using Schwab's proprietary subaccounting trade and order routing and reporting technology (Centerpiece) or similar outside technologies and leading account aggregation technology (Yodlee) and secure storage capability (Virtual Vault), Schwab makes it possible for investors to securely view all their account holdings, whether custodied inside or outside of Schwab as of the previous business day. For PMers who directly manage portfolios of individual securities, investors gain real-time reporting. For investors who would like the convenience of a secure storage facility for all their important documents, the advisor offers their clients a virtual vault with the most advanced security available. When an advisor wants to communicate with their clients, they can produce an on-line newsletter. They can send research, quotes, news and other communications. They can send secure messages and advisor-branded alerts. They can even create their own web cast - all tied to contact management tools. Advisors can create their own web content through an easy-to-use web publishing tool so the look, feel and content of the site is totally customized to each advisor's wishes.

There is no limit, as to the technology, tools and services incorporated into advisor-branded services. All technologies will be integrated so they can be easily used without requiring client data to be downloaded or uploaded for each technological application. If a consultant wants Yodlee or Kinexus to develop data for an electronic asset study, they can get it. If the consultant wants PPCA's StockTrib to perform style-sensitive attribution analysis on money managers, Schwab advisor-branded web services can accommodate. If the consultant wants to use Rowe Decision Analytics to create a custom statement of investment policy with legal opinions that the portfolio is in compliance with UPIA, ERISA or MPERS, the advisor can incorporate that investment policy capability into their investment process, value proposition and branding. If the consultant wants to use FinanceWare's Monte Carlo simulation to better explain risk or

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portfolio performance to individual investors, Schwab advisor-branded services can integrate that technology as part of the advisor's investment process in developing their asset study and performance monitor. If the advisor wants to use RowPyn or another investment methodology for a guide to portfolio construction and tactical asset allocation, Schwab advisor-branded web services is flexible enough for the advisor to incorporate RowPyn into their investment process. In essence, Schwab's advisor-branded web services is the ultimate in open architecture in developing and integrating a custom configuration of tools, processes, technology and methodology necessary for the financial advisor to add value. Whatever intellectual property is necessary in order for the financial advisor to address and manage a broad range of investment and administrative values. Schwab can facilitate advisor access. Thus, the advisor can bring their own unique configuration of intellectual property to the table in shaping the technology, processes and methodology they use to define their investment process and value proposition. Most importantly, they gain a web platform around which they can build their practice and articulate their value proposition. This is the beginning of financial advisory practices becoming web-centric and operating in more of a closed loop designed to facilitate an extremely high level of service to 200 clients or less. Advisor-branded web services recognize the advisor is the value added and are structured to facilitate the advisor adding as much value as the advisor can possibly imagine.

> **IN THE EMERGING SUPERCHARGED, COMPETITIVE BUSINESS ENVIRONMENT, WHERE EVERYONE WILL BE FOCUSING ON PROVIDING FEE-BASED ADVICE TO INVESTORS, ... ONE'S ABILITY TO ADD VALUE AND TO ARTICULATE AND DIFFERENTIATE THEIR VALUE PROPOSITION IS ESSENTIAL TO THEIR SUCCESS**

The implications of advisory practices becoming more web-centric changes many of the core principals of financial services sales and marketing. In Senior Consultant's survey of practices at the higher end of the market, it was found that 80% of financial advisors use the web as their primary and preferred source for securing and managing information. Web-based tools, processes and technology designed to add value have already made these advisors, with over $100 million under advisement, web-centric. They are focused on managing an investment process through which they address and manage a broad range of investment and administrative values. All product decisions are made in the context of objectively determining the best managers to manage against a very specific investment mandate within each client's portfolio as measured by a style-based benchmark. This closed loop product decision-making process is totally inconsistent with the open loop product decision-making process in commission brokerage. Conventional commission sales support is narrowly focused on creating a never-ending stream of attractive sale stories with the rarely realized promise of returns being so extraordinary clients are moved to action. This is in contrast to investment products becoming incidental to an objective and accountable investment process through which a broad range of investment and administrative values are addressed and managed. The focus is on the investment process through which value is added, not investment products. Given the industry is fast-evolving toward adding value through fee-based advice, Schwab's advisor-branded services better reflects what the support infrastructure of the firm of the future will look like than today's product management structure geared to commission sales. By extension, this materially changes how product vendors market. From an advertising prospective, if a financial product organization cannot reach the high-end advisory services practices via the web with high level value-added editorial content that they will actually read, that financial product company may as well not exist. This not only changes the model for advertising (making www.SrConsultant.com invaluable) but changes the model for the wholesale support. Asset management firms must increasingly use technology to demonstrate their value in a larger overall portfolio construction consideration, such as Barclay's brilliant promotion of ETFs providing technological tools that help advisors illustrate how they can in reduce tracking error. All the rules of sales/marketing and client service are changing, as web-based processes and technology become the primary means through which the advisor adds value. Financial products will continue to be sold through commission sales to the mass market of 90% of all investors who have less than $100,000 that account for less than 10% of the investable assets, where fee-based advice is not economically viable. But the transparency of the internet will make it clear even to the mass market that little if any value can be added through a series of disjointed, unrelated transactions. As advisors focus on the 10% of investors who have 90% of the investable assets, the need for market differentiation among financial advisors becomes paramount. Thus, the logic behind Schwab's advisor-branded web services.

In the emerging supercharged, competitive business environment, where everyone will be focusing on providing fee-based advice to investors, both institutions and individuals, with more than $100,000 to invest, one's ability to add value and to articulate and differentiate their value proposition is essential to their success. There are only enough investors with $100,000 to sustain 75,000 of today's 650,000 licensed financial services professionals. The other 575,000 will be focused on the 90% of investors who just account for 10% of the investable assets. Thus, if one wants to excel, Schwab advisor-branded web services is perfectly conducive to building a world-class advisory services practice. Schwab's advisor-branded web services is the new referenced point around which the industry's support infrastructure will be measured. If you are a financial advisor who is engaging your professional investment and administrative counsel for an on-going advisor fee and your firm does not highly value your work or does not enthusiastically support the thesis of adding value, they may not be aware that there is a new competitor in town, who is building their business entirely around advisors just like you. Schwab is betting your firm will not be up to the challenge. ■

Notes

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