

SENIOR CONSULTANT

The Voice of the Investment Management Consultant

The Virtual Custodian: Changing The Financial Advisor's Value Proposition

L. Patrick Gardner, ByAllAccounts, Inc.

With the emergence of a new generation of technologies, the financial services industry is beginning to see that they can play an even more valuable and profitable role by providing holistic advice — advice based on a client's entire financial situation, regardless of the location of the client's assets. Furthermore, that expert advice can be offered on a fee basis, on *all* the client assets rather than just charging a trade execution commission over only those assets which the advisor has custody. Recurring fee revenues associated with advisors engaging in professional investment counsel commands three times the earnings multiple than commission revenues and generates an annuity stream versus a single transactional fee. From the client perspective, they prefer to compensate their advisors based on the overall success of the advice rather than just on a trade.

The appeal of providing holistic advice is even more evident during today's economic downturn. Only those financial advisors who are capable of addressing and managing a broad range of investments are significantly growing their businesses, regardless of asset location as required by both their clients and their fiduciary obligations.

The new processes and technology that enable the financial advisor to provide an unprecedented level of professional investment counsel also have the power to streamline organizational structures, significantly reduce costs and increase margins. In order to achieve the extraordinary economic benefits of a holistic approach, the financial services industry must embrace disruptive technologies that not only preempts commission brokerage technology but will forever change the value proposition of product/trade commission-driven advice.

This new disruptive technology is the virtual custodian platform. By fully utilizing the internet as a mech-

anism to gather and analyze dynamic real-time information, the advisor can receive the information necessary to provide holistic and timely advice. How important is this? This platform empowers the advisor to see all the clients' assets, regardless of location, and both manage and provide advice across a broad range of investments and constraints. Trying to provide holistic advice and guidance without it is like trying to build a house without plans — something vital will get overlooked and may have significant consequences. The virtual custodian platform means the difference

between one being adept or inept in addressing and managing a broad range of investment and administrative values.

The virtual custodian platform enables the advisor to evaluate the impact of an investment recommendation in the context of all the clients' assets and liabilities. Only after understanding the client's current asset and liability mix, goals, timelines and unique circumstances can the advisor determine an investment recommendation that will meet the objective of improving overall portfolio

returns, reducing risk, modifying asset allocation or enhancing tax efficiency, liquidity and cost structure. Without a virtual custodian platform, the advisor may perceive they are adding value, but the lack of knowledge of outside assets makes this perceived value minimal at best.

A recent Financial Research Corporation study found the average financial advisor has 245 relationships, with each client having nearly nine accounts each. This means the average advisor must continuously monitor 2,000 accounts if they are to add value for their clients. Essentially the virtual custodian platform makes it possible for the financial advisor to engage their professional investment and administrative counsel for an on-going advisory fee. A virtual custodian platform that gathers and analyzes data is

**ONLY THOSE FINANCIAL
ADVISORS WHO ARE
CAPABLE OF
ADDRESSING AND
MANAGING A BROAD
RANGE OF INVESTMENTS
ARE SIGNIFICANTLY
GROWING THEIR
BUSINESSES,
REGARDLESS OF
ASSET LOCATION ...**



essential in order for the financial advisor to add value for their clients. However, it should not stop here because adding value requires one to go beyond analyzing and monitoring data.

The virtual custodian must go beyond monitoring and analyzing data to provide the advisor access to the processes (asset/liability study, investment policy, strategic asset allocation, manager search and selection, performance monitor, tactical asset allocation) and the full suite of technologies (account aggregation technology, subaccounting), trade and order routing/reporting technology, gating technology which ties investment policy to portfolio management technology, client relationship management technology, data warehousing technology) necessary to add value. As shown below in Figure 1, the virtual custodian platform gathers, monitors and analyzes data, providing the advisor with refined, pivotal client information based on the personal goals and objectives of each client. The advisor technology continuum embodied in the virtual custodian takes data and translates it into information which, in turn, is translated into knowledge which, in turn, is translated into wisdom. The virtual custodian platform

empowers the advisor to translate data into expert advice. Understanding the four-level hierarchy of information management and the translation of data into expert advice provides insight into the dynamics of a virtual custodian platform. The hierarchy of information is data, information, knowledge, wisdom.

**Data:
Using Artificial Intelligence to
Understand Complex,
Transaction-Level Financial Data**

Investment data is the fundamental component to the wealth management industry. Historically it has been the ability of the advisor to get access to the data, regardless of timeliness, that has enabled them to provide value. Beginning in 1999, the first generation of account aggregation changed the equation. A simple application capable of scraping data via HTML from the websites of financial institutions enabled the client and advisor to see more of their investment data in a near, much more timely basis. However, because it simply represented the information with no added value, this great promise of changing the investment industry did not gain significant uptake. First-

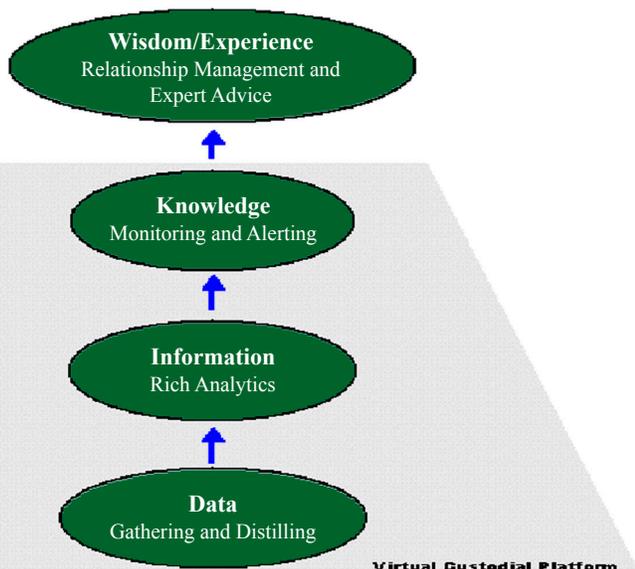
generation aggregation continued to be challenged by the lack of problems it solved and the absence of a return on investment. As with many new revolutionary technologies, the aggregation fell into a technology chasm, which is best illustrated in Geoffrey Moore's book, *Crossing the Chasm*. The data being gathered was not rich enough nor complete enough for advisors to do anything meaningful with it.

In 2000, a new generation of aggregation technology was introduced which required that data be gathered on a detailed transaction-level and then translated for analysis, optimization, monitoring and mining. Delivering this kind of data to empower the advisor is no small challenge. It requires a technology that goes far beyond the capability to gather, cleanse and normalize the data. Today's aggregation technology contains the artificial intelligence to understand what each data element is, what it does and how it fits into the process of portfolio management and optimization. Furthermore, the data must be enjoined with other fundamental information and pricing to give it context and enable its usage in a dynamic environment. Lastly, the aggregation capability must be broad enough to gather all accessible data, regardless of where it resides, and it must also feature the capability to manually input unique data elements. To accomplish this, second generation aggregation must be agnostic to the type of data gathered. Deep rich source system, direct feed data must be combined with the non-captive outside data, regardless of format, to establish the foundation for data to be transformed into information to empower the advisor.

**Information:
Making Recommendations That
Impact an Entire Portfolio**

Financial data alone is not enough. Only by transforming this data into information can the basis for the return on investment begin. Second-generation aggregation and the virtual custodian platform enable this transformation. Raw data is turned into useable information in a multi-step process. First, the advisor works with the client to understand specific goals, risk tolerances, time horizons, tax issues, estate issues and other many other concerns. Based on all of these parameters, the advisor then

**Figure 1.
Advisor Hierarchy of Professional Investment Counsel
Facilitated by the Virtual Custodial Platform**





constructs portfolios with specific allocation targets, risk and return parameters and personalized benchmarks to measure these criteria. The advisor must be able to leverage the technology to manage this process across all assets.

Second, the technology must be able to analyze the dynamically gathered investment data against all of the clients' investments, captive or non-captive. After all, how can you manage a third of the client's portfolio if you don't know how the recommendations you are making impact the other investments the client may hold? It is the ability of the technology and platform to deliver the analytics to the advisor, regardless of asset location, that enables the advisor to examine issues such as asset allocation concentration, risk exposure, investment performance and the factors affecting the changes in the client's net worth.

This process ultimately creates a wealth of information for the advisor to utilize in providing the value added advice and guidance needed to increase assets, streamline processes and increase margins.

**Knowledge:
Leveraging Information to Deliver
the Actionable Client Specific Alerts**

The immense benefit of the platform in creating the wealth of information for the advisor to now analyze and act upon creates another dilemma — information overload. The platform has changed what used to be the advisor's need to simply gather data into one that now requires analysis and delivery of timely, actionable knowledge to handle the vast amount of information that is created. It is the combination of the information within the virtual custodian platform that is designed to monitor the data in order to trigger alerts based on client's needs, that creates this knowledge for the advisor.

Because the platform has the information on all the client's assets regardless of location, the advisor can specify whether to look at events that affect overall exposure, investment performance, goal attainment, security or cash movements, etc. The platform then monitors the client's dynamic investments and delivers

to the advisor the knowledge that an event requires either research or action.

The knowledge that the platform delivers to the advisor are opportunities to increase new assets under management, increase client retention and improve the efficiency of delivering information to the client.

**Wisdom and Experience:
Doing What You Do Best**

The goal of the virtual custodian platform is not to eliminate advisors but to empower them. In fact, it is the advisor who ultimately applies his/her wisdom to the information and knowledge that the platform creates. It is the skills of the trusted advisor, the experience, the judgment and the instinct, coupled with the pivotal holistic data, that creates the valued added guidance.

Bloom's Taxonomy Table shown on the next page illustrates the hierarchy of how data, information and mining technology drives the advisor's competence.

The virtual custodian platform is only the means for delivering the knowledge to the

THINK ALL ETFs ARE THE SAME? THINK AGAIN.

iShares

Industrial strength investment tools from
BARCLAYS GLOBAL INVESTORS

The resources at iShares.com are designed specifically with advisors in mind. They are the same ideas and concepts institutional asset managers use, and can help you make more informed investment decisions for your clients.

Visit iShares.com to access our ETF products, precise, yet easy-to-use tools and advisor portfolio strategies.



For complete information, call 1-800-iShares for a prospectus. Read it carefully before investing. iShares are distributed by SEI Investments Distribution Co. (SEI). Barclays Global Fund Advisors (BGFA) serves as an advisor to iShares. Barclays Global Investors Services (BGIS) assists in the marketing of iShares. BGFA and BGIS are subsidiaries of Barclays Global Investors, N.A., none of which is affiliated with SEI. Investing involves risk, including possible loss of principal.

© 2003 Barclays Global Investors. All rights reserved. iShares is a registered trademark of Barclays Global Investors, N.A.

Figure 2.
Bloom's Taxonomy Table

Skill Level	Competence	Description
Highest ↑	Evaluation	assess, decide, test, measure, conclude, verify
	Synthesis	combine, integrate, plan, create, design, modify
	Analysis	recognize, separate, explain, connect
	Application	apply, demonstrate, illustrate, classify
	Comprehension	group, compare, contrast, associate, describe
Lowest	Knowledge	facts, list, dates, events, quote, name

advisor. Advisors who embrace it will change the client value proposition and succeed in gathering more client assets over the long-term.

The Value Proposition and ROI Drivers

Understanding, even in broad terms, what the virtual custodian platform is, one is most likely beginning to see the significant differentiation this could bring to the marketplace and the potential it brings to increasing one's revenues. Specifically, the value proposition can be classified and quantified in three key categories:

Growing Assets Under Advisement and Profitability

- Leveraging data to increase assets under advisement. If you are providing the best and most insightful service, you are likely to be awarded with additional mandates.
- Extending fees to advise on non-captive assets. Today most advisors only charge advisory fees on assets over which they have custody. *McHenry Consulting* has published a white paper ("High Net Worth Data Aggregation: Realizing the Profit Potential, 2002) on the regulatory and compliance issues on charging fees on held-away assets. Not only is it allowed, it is highly opportunistic.

Focus on Client Retention and Acquisition

- Arming advisors with actionable information to eliminate portfolio surprises. This is the bottom line to most advisors, because no one wants their clients to hear breaking news from someone else.
- Providing more in-depth information for enriched dialogues with client. Systematic processes are proven to be the best ways to build the strongest relationships.
- Powering advanced analytics and decision support tools. Data can also be used to allow the advisor to collaborate with the client or other professional, tax accountant, lawyer, etc.

Improve Operational Efficiencies

- Eliminating manual data gathering procedures.
- Creating and running complex analysis on this compiled data.
- Monitoring total client portfolios provides significant timesavings.
- Automating client consolidated reporting.
- Exportability of the entire database for other applications.

The Virtual Custodian: Forever Changing The Financial Advisor's Value Proposition

In an industry that is highly structured around product silos, the support provided to the advisor is limited, impeding a holistic approach and potential value being added. The advisor that leverages the virtual custodian platform has the potential to turn his or existing model of providing advice on only assets captive assets and on a commission basis upside down. Thanks to the emergence of a new generation of aggregation technology and the virtual custodian platform, which provides transparency on all of a client's holdings, the advisor can leverage this information through expert systems to provide their clients with the critical knowledge and wisdom needed to synthesize the sets of investment considerations necessary to add value. ■

About the Author

L. Patrick Gardner is president, CEO and co-founder of *ByAllAccounts, Inc.*, which was recently ranked by industry analyst, *Celent Communications*, as the top-rated advisor aggregation firm. *ByAllAccounts* provides technology designed to grow assets for financial institutions and their advisors by collecting, monitoring and analyzing financial data from captive and non-captive client accounts, enabling advisors to build stronger, more profitable client relationships. For more information, visit their [web site](http://www.ByAllAccounts.com) www.ByAllAccounts.com.

SENIOR CONSULTANT

THE VOICE OF THE INVESTMENT MANAGEMENT CONSULTANT

JAMES P. OWEN
Co-Founder

STEPHEN C. WINKS
Co-Founder, Publisher & Editor-in-Chief

SYDNEY LEBLANC
Consulting Editor

MAMIE WOO MCNEAL
Production Editor

EDDIE BRYANT
Marketing Consultant



Advisory Board

JERRY BOTT
Bott Anderson

JOHN BROCK
Brock-Hazzard/Wachovia Securities

DICK CHARLTON
New England Pension Consultants

BOB CLUCK
Canterbury Capital

HAROLD EVENSKY
Evensky Brown & Katz

JEFF FRUM
Wells Fargo

RICH GLEASON
Salomon Smith Barney

KATHLEEN E. HEGENBART
Salomon Smith Barney

BRIAN HUNTER
Prudential Securities

GREG HUNTER
Merrill Lynch

BILL JOHNSON
CapTrust

JOHN KELSEY
Salomon Smith Barney

KEITH PHILLIPS
Morgan Stanley Dean Witter

BOB ROWE
Morgan Stanley Dean Witter

DICK SMITH
Cap Group

JIM YANNI
Yanni Partners

SENIOR CONSULTANT

1457 Crystal Springs Lane
Richmond, Virginia 23231

Ph 804-643-1075 ■ Fax 804-643-1544

WWW.SRCONSULTANT.COM