The Changing Face of Financial Advice: 2015 and Beyond

STUDY PREVIEW

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Introduction

From a distance, the wealth management industry has never looked stronger. Financial markets have fully recovered from the crash of 2008 and financial advisor productivity is at an all-time high. Demand for investment advice is strong and growing. Investors who already work with a financial advisor are for the most part very satisfied. Advisors have embraced a team approach to serving clients, enabling them to offer more sophisticated planning and investment management to a broader array of investors. Most advisors are confident in the growth prospects of their individual practices and expect to be doing even better next year than they are today.

Looking closely, however, cracks in the industry's foundation become clear. For one, the market's performance since 2008 has been driven in large part by unsustainable central bank stimulus. As interest rates rise in the next few years, market volatility and the potential for a sustained bear market will increase. Since the financial crisis, advisors and the broader wealth management industry have tried to change the focus of the client relationship from performance to goal-based planning. Investors have been open to this shift, but our research shows that investment performance still trumps nearly every other aspect of the FA-client relationship. Should the market stagnate, clients will question the value of their advisor as they did in the wake of the financial crisis, and they will have more alternative advice providers to choose from than ever.

As we enter increasingly uncertain market conditions, advisors and the firms that support them will face a host of demographic, technological and competitive challenges. Since 2007, more people have exited the advice industry than entered it. The result is an advisor force that is predominantly old, white, male and not as diverse as the nation at large. This isn't a problem for serving the existing client base, which exhibits the same traits, but it will be an issue as older male clients' assets wind down and younger, more diverse investors and often female-headed households earn economic clout. The last point in particular poses a challenge: women prefer to work with female advisors, but just 30% of today's advisor force is female.

From a technological standpoint, our research shows that most advisors fail to take advantage of the wealth of resources available in today's marketplace. Fewer than half of the advisors we surveyed use customer relationship management (CRM) software or account aggregation technology to see their clients' full financial lives. Most FAs use social networking, but their activities have little bearing on client service and don't make them more efficient in their day-to-day account management role. From a client-facing technology standpoint, the major full-service brokerage firms offer sub-par mobile and online capabilities that will make it difficult for them to satisfy Generation X and Y clients.

Beyond talent and technology issues, the competitive landscape is increasingly crowded, providing emerging affluent investors with more alternatives than ever. Firms like Charles Schwab, Fidelity and Vanguard have moved beyond asset management and self-directed brokerage to a hybrid model that combines managed accounts and guidance with cutting edge technology, all delivered at an exceptionally low cost. Powered by hundreds of millions of dollars in venture capital, startups like Betterment, FutureAdvisor and Wealthfront have vowed to disrupt the investment industry and bring advice and managed money to the masses. Improved technology and low-cost index ETFs have made it easy for such startups to produce customized low-cost portfolio recommendations for consumers. This represents a compelling value proposition to younger investors who are skeptical of traditional wealth managers and demand strong but inexpensive self-service functionality.

In our new report – **The Changing Face of Financial Advice: 2015 and Beyond** – we identify the key challenges facing the advice industry, both internal and external, and assess their strategic implications. We share findings from two surveys we conducted in February 2015 – one of investors with at least $100k in investable assets and one of advisors – and explore the gaps in perception between these two groups. Our research paints a picture of an industry in flux, one that isn't prepared for the change that's coming but that still has the time and potential to alter course and to succeed given the right mix of people, processes and products. **The Changing Face of Financial Advice** offers our in-depth analysis of the industry's problems and provides detailed recommendations to help wealth management firm executives plan for and succeed in the uncertain times ahead.

Methodology

Working with Research Now, Corporate Insight conducted two parallel surveys in February 2015 to serve as the foundation for this report on the future of financial advice.

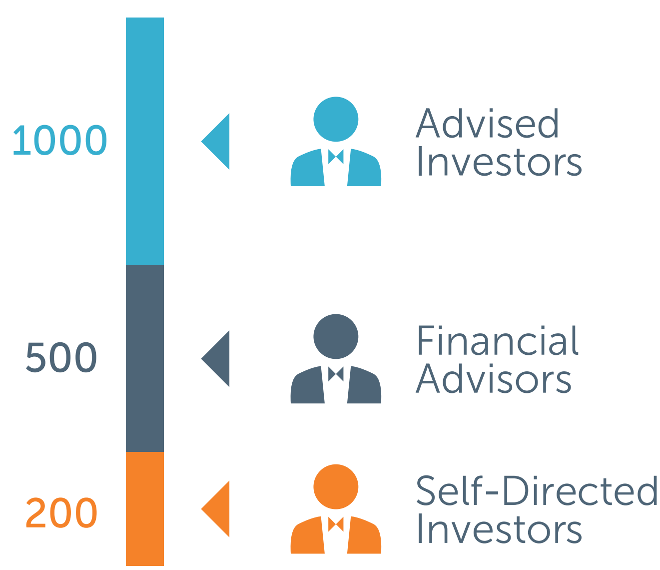
First, we surveyed approximately 1,000 advised investors, all of whom had at least $100,000 in liquid household assets. We also surveyed 200 self-directed investors who met the same $100,000 asset threshold, to understand how their preferences, behaviors and perceptions differ from those of similarly affluent investors who rely on a financial advisor.

Second, we surveyed 500 financial advisors, posing many of the same questions we asked investors to answer. The goal was to identify differences in FAs' and investors' perceptions on such key topics as overall satisfaction, communication preferences, the role of technology in the relationship and the appeal of non-traditional competitors. We then tabulated and analyzed the survey data by a number of different demographic factors, including age, assets, income, trading activity and other attributes.

In addition to our proprietary survey data, we interviewed dozens of financial advisors and subject matter experts in financial services and marketing roles with specific knowledge of the challenges facing advisors. Our conversations covered a range of topics, including interviewees' perspectives on investor satisfaction, client- and advisor-facing technology, compliance and competition. We also leveraged our proprietary Monitor, Next-Generation Investing and Brokerage Audit digital benchmarking research along with relevant publicly available survey data, research papers and publications. Where applicable, we reference data from additional consumer surveys that Corporate Insight has commissioned in recent years, including a 2013 investor survey focused on the brokerage website experience.

The result is a report that should help readers better understand the challenges advisors will face as they seek to satisfy their existing clients while also targeting and acquiring the next generation of investors.

Our Survey Sample



FAs Don't Fully Understand Investors' Priorities (Excerpt)

Downward pressure on fees is only starting.

Like all rational consumers, investors want to get the best service at the lowest cost. That said, clarity and simplicity of fees actually matters more to investors than the fee itself. Specifically, 74% of investors said it was "very" or "extremely" important that their advisor or brokerage firm offer simple, clear fees while 68% said cost itself was "very" or "extremely" important. Advisors underestimated the importance of fees to clients, with only 58% and 53% giving top-two-box ratings to these considerations, respectively.

While investors don't necessarily see fees or pricing as critically important, cost can become a sore spot. When we asked investors about their top complaints with their advisor and/or brokerage firm, the top three gripes were all fee-related: "Fees are too high," "Fees are hard to understand or lack transparency" and "Fees are too rigid/inflexible." It came as no surprise that self-directed investors were more sensitive to pricing than full-service investors, given their choice of primary brokerage firms. Seventy-seven percent (77%) of self-directed investors gave a top-two-box rating to clarity and simplicity of fees and 75% to the cost of their brokerage firm's services.

Our interviews for this study suggest that advisors think self-directed investors are distinct from advised investors. While this might be true of older investors, younger prospects are more likely to have expectations that are similar to those of self-directed investors. Generation X investors in particular are known for taking a do-it-yourself approach to their finances. Their first exposure to investing was through discount brokerage firms like Schwab and Fidelity, which evolved into hybrid firms that offer many of the products and services that were once exclusive to full-service brokerage firms but at a much lower cost. Millennial investors are digital natives who are used to comparison shopping and who rely on peer reviews and ratings when making major purchasing decisions. These two generations have the ability to compare services and pricing more easily than past generations. They are naturally more likely to question their financial advisor's cost of services and pricing structure. And as low-cost, digitally sophisticated alternatives continue to multiply, the traditional full-service brokerage firm may struggle to justify current pricing to these potential clients...

Full-service firms still undervalue customer-facing technology.

Many advisory firms treat the customer website and mobile platform as an afterthought. This reality is reflected in our survey data, which showed clear differences in how financial advisors and investors rated these technological aspects of the overall customer experience. This disconnect is indicative of an industry that is failing to adjust to evolving client expectations.

Financial advisors recognized that their clients' level of satisfaction with their firm's customer-facing technology was low, with only 14% indicating that their clients were "very satisfied" with their firm's website, and 11% with their firm's mobile offerings. It came as no surprise that the lowest level of investor satisfaction was with their firm's website for all age groups, with only 29% of advised investors indicating that they were "very satisfied." Over the years, Corporate Insight's Brokerage Audit service has found that full-service brokerage firm websites have consistently lagged behind self-directed and hybrid brokerage firms by significant degree. We grade brokerage firms' websites on a four-point scale, from "Poor" (1) to "Excellent" (4). The average full-service firms fail to earn a "Fair" rating, with a 1.98 average score versus 2.98 for hybrid firms.

While advisors recognize their client-facing technology is weak, they tend to underestimate the importance of these offerings. Only 27% of advisors said their firm's mobile platform was "very" or "extremely" important to clients (i.e., a top-two-box importance rating on a five-point scale), making this the least important customer experience element in the advisor's mind. This probably reflects the fact that wealth management firms have been slow to embrace mobile, just as they were initially slow to embrace the web. Though only 21% of advised investors gave a top-two box-rating to mobile, 32% of investors under 50 gave the same rating. In our December 2013 survey, 57% of Millennials gave a top-two-box rating to having access to their brokerage account via a mobile device.

FAs think the customer website matters more than the mobile platform, but still isn't all that important. Just 42% said the client website was "very" or "extremely" important. In contrast, 55% of advised investors gave their firm's website a top-two-box rating. Unsurprisingly, younger investors put more value on web offerings (59% versus 54% for older investors). Regular website users also place higher value on the online experience. In December 2013, we surveyed advised investors who used their firm's website at least once in the past six months. We found the importance of the web channel was significantly higher, with 92% giving it a top-two-box importance rating.

A recent study by Capgemini and RBC Wealth Management found that "nearly two-thirds of the world's High Net Worth Individuals expect to manage most or all their wealth relationship digitally in five years and would consider leaving their current firm if an integrated channel experience is not provided."[1] The demand for online and mobile account management isn't something limited to young investors. It's become the expectation of every generation...

[1] Courtney Finn, Cortney Lusignan, Claire Holland, Timi Oni. "Digital Demands of High Net Worth Individuals Signal Flight Risk." RBC Wealth Management. 2014.

Advisors and Wealth Management Firms Are Not Making the Most of Technology (Excerpt)

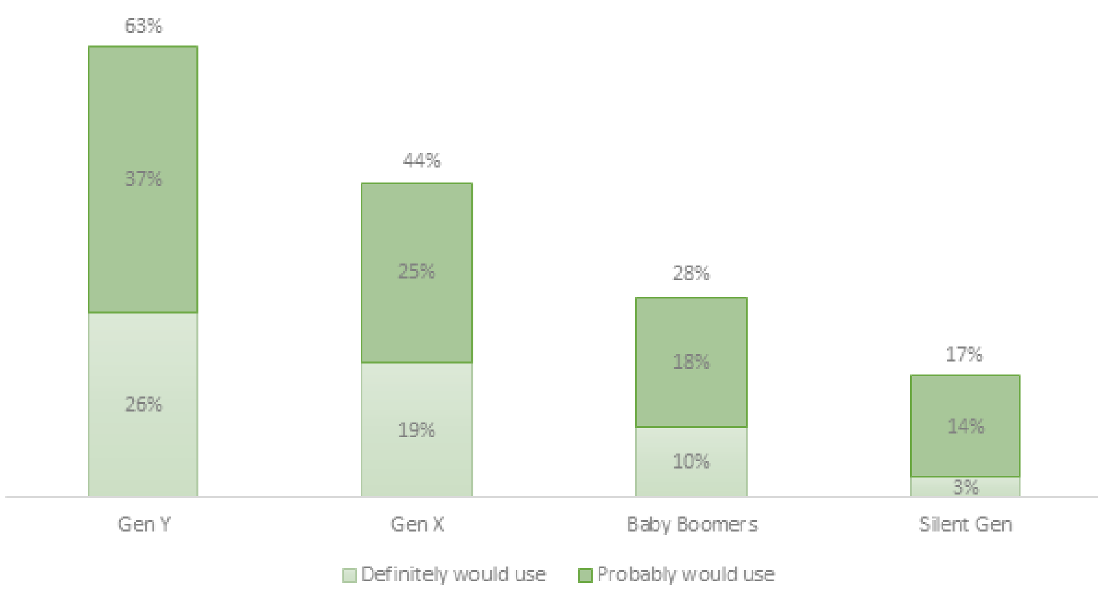
Video conferencing is beginning to emerge as a viable communication channel. Advisors should embrace this development.

Video conferencing is not as popular today as traditional in-person interaction, but in the long run, it will become more widely available and more important to the FA-client relationship. As one advisor put it, "Video conferencing is similar to the fax machine in that it won't be adopted until everyone has it." But as smartphones increasingly put video chat technology into consumers' hands, everyone will eventually have it.

Face-to-face meetings are a big time commitment for advisors, particularly those with large books of business and geographically-dispersed clients. Video conferencing technology could offer some much-needed relief, helping FAs maintain close relationships while reducing the need for travel. Vanguard is making it a key component of its Personal Advisor Services (PAS), which combines the appeal of a very low-cost online managed account like Betterment or Wealthfront with access to a human being via Apple's FaceTime video service. Vanguard has no branches, so FaceTime will provide a virtual space for clients and advisors to meet face-to-face. PAS will provide an interesting test case for the industry and one that advisors and their firms should watch closely.

We asked investors about video conferencing and found interest differed dramatically by generation. Older, less technologically-sophisticated investors were much less open to it, while younger "digital natives" were clearly interested. Sixty-three percent (63%) of Gen Y and 44% of Gen X reported that they "probably" or "definitely" would use video conferencing to communicate with their FAs if this were an option.

Figure 11: Would you be willing to use video conferencing to interact with your financial advisor?



[2]Emily Zulz. "Schwab, Vanguard Threaten Robo-Advisors' Existence: Cerulli." ThinkAdvisor. April 8, 2015.

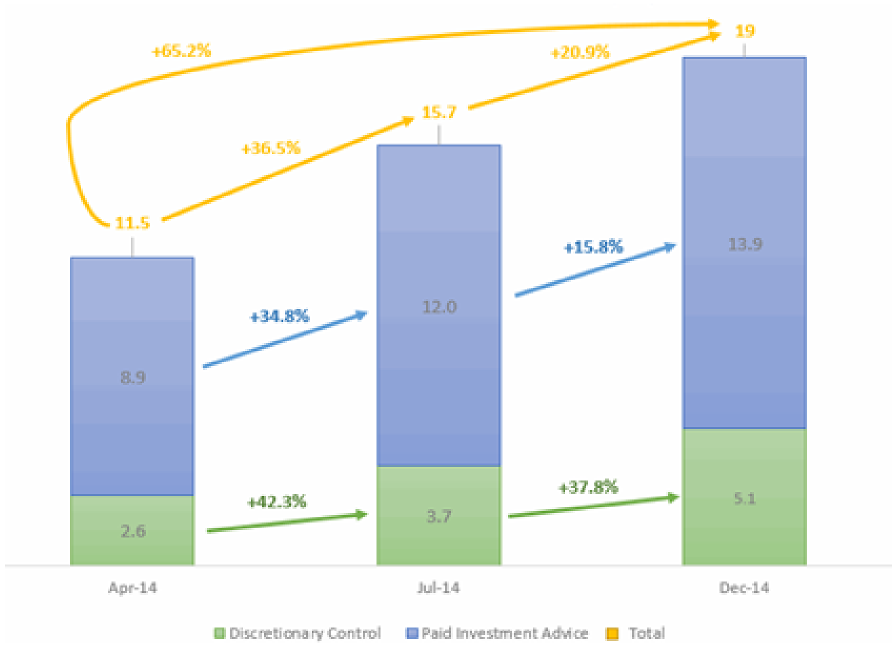
New Competitive Threats Will Challenge Existing Wealth Management Firms (Excerpt)

In the wealth management industry, 2014 was the year of the "robo" advisor. Leading digital advisor startups like Betterment and Wealthfront accumulated tens of millions of dollars in venture capital financing last year, while at the same time acquiring hundreds of millions of dollars in new assets under management. In December 2014, Corporate Insight collected management numbers for 11 relatively established startups and found that they were advising nearly $19 billion, with over $5 billion under discretionary control. This represents a 65% growth rate since we first collected this information in April 2014, just an eight-month span. By comparison, U.S. retail investment assets held with traditional firms only increased by 7% for the entire 2014 calendar year.[3]

The forces behind the online advice phenomenon are many. Improved technology and low-cost index ETFs have made it easy for a knowledgeable startup to customize inexpensive portfolio recommendations for consumers. This fills a need for advice among millions of mass market investors who have been underserved by full-service brokerage firms in recent years. In response, mainstream firms like Schwab and Vanguard announced their own robo advisor offerings, while firms like Fidelity and TD Ameritrade entered partnerships with startups like Betterment and LearnVest to provide their services to RIAs who custody assets with them. Northwestern Mutual then acquired LearnVest, leading to speculation that major financial institutions could begin an acquisition spree to jumpstart their innovation efforts and close the perceived technology gap between their offerings and the capabilities provided by these startups.

Digital advice startups are redefining the price point and delivery of financial advice. While many hybrid firms are responding by releasing their own equivalents or partnering with these innovators, traditional wealth management firms are not. Financial advisors and the firms they represent must awaken to these new challenges and seek innovative solutions in order to remain competitive in the years ahead...

Figure 13: 2014 Growth of Low-cost Investment Advice Startups (in Billions of Dollars)



[3]"Unifying the Advisor and Investor Experience: The Rise of Client-Centric Wealth Management." Aite and Scivantage. March 10,2015

About Us

Corporate Insight (CI) provides competitive intelligence and user experience research to the nation's leading financial institutions. For over 20 years, Corporate Insight has tracked new developments in the financial services industry through our Monitor research and custom consulting services. We are known for our detailed, objective research, unmatched expertise, and emphasis on the actual user experience. There are no assumptions in CI's work – we use live accounts at the firms we track to benchmark their effectiveness and give our clients unparalleled competitive intelligence.

Corporate Insight is continuously tracking and identifying best practices in online asset management, banking and investing, insurance, annuities, mobile finance, active trading platforms, social media and other emerging areas. In the process, we have helped our clients across financial services stay on top of industry trends and improve their competitive position.

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