Reimagining the Role of Investment Advisors

How the Digital Revolution is Changing the Way Advisors Work to Achieve Success

Abstract

What is the impact of emerging technologies on investment advisors? The answer lies in the growth of advisor portals. Enterprises have started to trigger a digital revolution that rolls out new avenues for investment advisors to access information and conduct transactions anytime, anywhere. Portals enable advisors to become truly mobile, enhancing their sales effectiveness and overall ability to service customers.

Advisors: Playing Financial Concierge to High Net Worth Individuals

Technology solution providers aspiring to move up the vendor value chain need to understand the underlying dynamics of the advisor space. The ability to translate the seemingly one-off requests for functionality and relate these to the larger problem space can act as a key differentiator.

Market volatility, changing regulatory requirements, increased service demands, advancement in technology and increased competition are posing challenges to building innovative solutions for interoperable and cohesive systems. This whitepaper:

- reveals the challenges faced by advisors, with particular focus on those providing services to High Net Worth Individuals (HNWI)
- explains the underlying complexities faced by the advisor community
- defines the role of an advisor portal

Stressed Out? Regulations Can Help Advisors Deal with It

In the United States, the Securities and Exchange Commission (SEC), in recognition of the critical role advisors played in the nation's economy, established a formal framework governing the registration and regulation of Investment Advisors. The Investment Advisors Act of 1940 defines an "Investment Advisor" (IA) as someone who, for compensation, engages in the business of advising others, either directly or through publications or writings, in, purchasing, or selling securities, and analyzes or reports on securities. A professional investment advisor is under a legal contract with the consumer to provide the best possible advice for managing financial assets. According to the Investment Advisor Registration Depository (IARD) as of May 3, 2010, more than 11,000 advisors registered with the SEC managed over USD 38 trillion for more than 14 million clients.

In the emerging markets such as India, where regulation has not reached the level of sophistication as in the US, some initiatives are already under way. For example, in India, the Securities and Exchange Board of India (SEBI) drafted the Investment Advisors Regulations in the year 2007. This was along similar lines of the US SEC's Investment Advisors Act of 1940. In December 2011, SEBI proposed new rules for investment advisors that require them to be registered with a Self-Regulatory Organization (SRO) before undertaking the role. The proposed framework intends to regulate investment advisory services in various forms including independent financial advisors, banks, distributors, and fund managers. It also seeks to remove ambiguity in the role and responsibility of IAs as well as provide a legal framework for enforcing fiduciary responsibility.

…Where Advisors Fear to Tread

Managing the investment portfolio of a HNWI is no mean task. An advisor has to typically address the following challenging areas:

1. While HNWIs form a huge market, the biggest challenge for an IA is to gain trust and subsequently the business of customers. The Capgemini and Merrill Lynch Wealth Management "World Wealth Report 2011," states that there are 10.9 million HNWIs worldwide, of which around 3.4 million are in North America. This corresponds to a combined wealth of USD 42.7 trillion, of which USD 11.6 trillion is concentrated in the US. In this environment, most IAs acquire new clients by recommendations from existing clients or references from common contacts like Banker Managers. IAs define USD 25 million plus as the entry level criteria for onboarding and providing high quality services to HNWIs. Clients that fall between the USD 500,000 to USD 25 million bracket have to rely on a smorgasbord of service providers to maintain their portfolios, without getting the benefit of holistic professional advice from IAs.
2. An advisor is expected to manage the entire net worth of his clients including immovable property, securities, charities, etc.

   In a fast changing economic climate, it is a challenge to perform different levels of analysis for each client. An advisor not only performs financial but also technical analysis of individual holdings. They need to process vast amounts of information in order to make a buy/hold/sell decision while trying to maintain the investment objectives of balancing the asset class mix. IAs can protect customers from volatile/risk prone areas of the market well before it hits a downturn. In most cases, clients place specific instructions of not investing their wealth in sin-stocks like tobacco, alcohol, or environmentally insensitive stocks. This discretion is sometimes referred to as Ethical Investing or Socially Responsible Investments (SRIs).

3. One more challenge is managing held-away assets not directly managed by advisors. The quality of advice offered by an IA directly impacts the 360-degree asset knowledge owned by the clients. For example, an IA would not advise investment in real estate if the client already has an exposure to the real estate market. From the client's perspective, compiling a quarterly statement of all IAs and self-management of investments proves to be a nightmare. In such circumstances, an IA offering 360-degree knowledge tends to win more business/clients due to the high quality of advice provided to the existing client base. Compiling held-away assets is a non-trivial exercise and several companies specialize in providing such services. The challenge is providing reliable reference data for such assets.

4. The Separately Managed Accounts (SMA) space has led to innovations such as Unified Managed Accounts (UMA), which was instituted around 2005. The primary difference between the two, as defined by Investopedia, is that an investor who wants a well-diversified portfolio of stocks, bonds, and mutual funds, needs to open three separate accounts in SMA; whereas UMA removes the need to have more than one account and combines all assets into one account with single registration. It is backed by US industry heavyweights such as Depository Trust and Clearing Corporation (DTCC) in collaboration with Money Management Institute (MMI). DTCC has provided the required technology infrastructure in the form of Model Management Exchange (MMX)—a product offering from DTCC Solutions LLC, a wholly owned subsidiary of DTCC.

   A study conducted by Dover Financial Research, focusing on top 20 model managers, found that UMAs have doubled the assets of investors between 2009 and 2011 to USD 139 billion by Q2, 2011, while the overall market in Q4, 2012 was estimated to be around USD 2.1 trillion. Prior to this solution, sponsors (i.e. broker/dealers) and investment managers had to rely on disparate systems and adhoc processes to manage their model distribution—resulting in significant inefficiencies and risk within the model/UMA marketplace. The success of this initiative can be gauged from the fact that Morgan Stanley Smith Barney, the market's largest SMA sponsor with USD 157 billion in assets, signed up for the service in early 2011.

5. Compliance with ever-increasing stricter regulations places additional burden and restrictions on advisors. Some of the regulations are:
   - Investment advisor disclosures: This requires the investment advisors registered with SEC to provide new and prospective clients with a brochure and its supplements written in English. These amendments are designed to provide new and prospective advisory clients with clearly written and meaningful current disclosure of business practices, conflicts of interest and a background of the investment advisor and its advisory personnel. Advisors must file their brochures with SEC electronically, which in turn will make them available to the public through the SEC website.
   - Custody of advisory client assets: The amendments are designed to provide additional safeguards under the Advisors Act. In this act, a registered advisor has custody of client funds or securities and the advisor is required
     - to undergo an annual surprise examination by an independent public accountant to verify client assets
     - to have a qualified custodian that can maintain clients' funds and send securities account statements directly to advisory clients—verifying their assets
     - to obtain or receive a report safeguarding the custody of the client's assets. The report, prepared by an independent public

    accountant registered and inspected by the Public Company Accounting Oversight Board, must describe the controls that are in place to protect the assets
  - to provide better information about the custodial practices of registered investment advisors to the commission and the public
- Political contributions by certain investment advisors: This regulation prohibits an investment advisor from:
  - providing advisory services to a government client for two years after the advisor or his executives/ employees make a contribution to certain elected officials or candidates
  - providing or agreeing to provide payment, directly or indirectly, to any third party for solicitation of advisory business from any government entity on the advisor's behalf, unless the third party is a registered broker-dealer or investment advisor
  - soliciting from others, or coordinating contributions to certain elected officials or candidates where the advisor is providing or seeking to provide advisory services.

6. According to the Capgemini and Merill Lynch Wealth Management "World Wealth Report 2011", in these uncertain times there has been a shift in the mindset of the HNWI community towards preserving capital and expecting their financial strategies to help achieve life goals instead of just meeting some arbitrary investment benchmarks. In recent times, there has been a considerable shift in the advisor business model where advisors are switching from the Assets Under Management (AUM) compensation model to a flat-fee or retainer model. During a downturn, if AUM drops due to market conditions, the AUM model reduces the percentage of advisor's fees. Conversely in a market upswing, AUM increases the percentage of advisor's fees. Both situations are unfair to the client since the advisor has done nothing to address the market conditions. In the retainer model the fee charged is based on the services provided.

   For example, the fee charged can be based on the number of client calls handled and the suite of services provided like portfolio rebalancing, financial planning advice etc. While this approach may yield lower revenues in the short term, it aligns closely with the client's objective of meeting life goals that are not necessarily linked to AUM performance. This in turn can lead to higher number of referrals from satisfied clients, increasing business in the long run.

7. With social media seamlessly connecting people, an advisor could be inundated with questions or challenged decisions by active ("hands on") clients. IAs are having a tough time staying ahead of HNWIs who have gathered collective intelligence through social media. This can potentially become a major relationship issue due to the fact that the most precious commodity for an IA is time.

Want to be Successful? 'Go Digital'

Advisor ability is closely linked to the business model and their ability to maintain and grow businesses. There is no single, integrated solution available in the market that meets all the needs of the advisors. Each advisor has to either buy or customize a solution based on the needs of the client. Most of the advisors uses excel spreadsheets as makeshift integration points.

IAs have to deal with a Customer Relationship Management (CRM) system, a financial system of record, a broker/dealer portal, and a source of market intelligence/analysis like Bloomberg or Morning Star. IAs also have to consolidate and report on the net worth of their clients and prepare a portfolio performance and tax guidance. Generating proposals for new client on-boarding is also a significant time- consuming activity. An ideal Advisor Portal would cater to the needs of IAs and enable them to share management reports and simple what-if analysis scenarios with clients.

Brokers/dealers have taken the lead in enabling technology-centric solutions. Most of them have developed solutions that enable an investor to buy/sell stocks, bonds, mutual funds, currencies, and derivatives. They also provide sophisticated modeling tools and free education on trading strategies. The solutions can either be installed via DVD or delivered via a Web portal.

Organizations using the Web deployment model need to ensure that all the data (reference and real-time) and computation algorithms required are available in a timely fashion. These systems lack the personal touch of an IA. They are also unable to diversify their portfolio of life goals such as contributing to the community via charities. To bridge this gap, brokers/dealers closely align themselves with IAs—gaining the trust of HNWIs.

The Coforge Thought Board:

Reimagining the Role of Investment Advisors

What are the Key Functions of an Investment Advisor?

Compensation, engagement in the business of advising others, analyses and management of customers' financial assets, and reporting of concerned securities.

What Regulations do Investment Advisors Follow?

The Securities and Exchange Commission (SEC) in the US, Securities and Exchange Board of India (SEBI), among others.

What Challenges do Investment Advisors Face with HNW Customers?

Gaining the trust and business of customers, managing the entire net worth of the clients, managing held-away assets, disparate systems, and ad-hoc processes to manage their model distribution, compliance with ever-increasing and stricter regulations, market conditions, and use of social media.

How are Technology-centric Solutions Provided to the Client?

By means of DVD

or Web portal

What are the Advantages of an Advisor Portal?

Immediate Return on Investment (ROI)

Direct communication with clients

Easy publication and storage of key documents

Doing the Math: How Advisor Portals Add Up

Given today's competitive environment, advisors need to adopt the latest technology to deliver high levels of customer service. Advisor portals are powerful technology solutions that deliver immediate Return on Investment (ROI), provide advisors with an efficient and flexible platform to communicate with the clients, and publish and store important documents. IAs drive operational efficiency and enhance firms' profitability by using advisor portals.

For more information, contact information@coforgetech.com

Coforge is a leading global IT solutions and services organization which believes that real transformation cannot be driven by thinking in technology terms alone. With a mission to "Transform at the Intersect" it aims to bring both deep domain and deep emerging technologies expertise to achieve real-world business impact. A focus on very select industries, a detailed understanding of the underlying processes of those industries and partnerships with leading platforms provides us a distinct vantage. We leverage AI, Cloud and Insight driven technologies, allied with our industry expertise, to transform client businesses into intelligent, high growth enterprises.

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