"THERE'S A REASON THEY CALL IT PERSONAL FINANCE"

Kevin W Quigg, State Street Global Advisors

LAND OF THE FREE

As Australian advice finds its feet in the fee-for-service world, there is plenty to learn from the American experience

Story by Aleks Vickovich

MORE THAN any other society, the United States subscribes to the idea that the pursuit of wealth and the pursuit of happiness are inextricably entwined.

While Europe still flirts with socialism and Australia hesitates to shake off the shackles of its protectionist past, America has long embraced individual economic liberty as a cultural foundation stone. As a result, the nation's personal finance – and professional investment advice – environment is dynamic, confident and unfaltering in its mission to help Mom and Pop achieve growth and meet their financial goals.

Australia might not be a nation of natural fiscal conservatives, and admittedly, there are some core cultural differences. But as Australian advisers go about the process of forcibly adapting to legislative change and planning for the 'generational wealth transfer' (one of many American advice buzz terms), the movements and trends in the post-GFC US advice landscape offer some serious food for thought.

Indeed, some of the more entrepreneurial Aussies are already watching closely.

It was the striking dynamism of American capitalism that drew a young Santi Burridge and Jon Reilly of Implemented Portfolios (IP) to New York almost a decade ago. Having come back year after year, they are convinced that America offers a glimpse of the Australian advice future, and these days they invite clients and other stakeholders along for the ride.

With the financial services industry in political turmoil back home – a state that engulfed the US industry during the Dodd-Frank negotiations following the GFC – I decided to tag along, to see whether the brash promise of American wealth management was just talk, or whether in fact the Yanks are onto something.

State of play

Well before the 1773 Boston Tea Party and throughout the country's political history, a majority of Americans have been highly sceptical of government intervention in the economy. While the Dodd-Frank reforms, championed by the Obama administration as an antidote to Wall Street's excess, went some way to reversing the trend, the American financial services industry is in fact far less regulated than Australia's.

While our industry associations and lobbyists spend most of their time trying to defend against the claw of government over-reach, their US counterparts are actually pushing for the contrary.

"In the United States, there is no regulation of financial planning per se, so it really comes down to the 70,000 or so who have voluntarily taken it upon themselves to undertake [CFP] certification and abide by our standards of conduct in the provision of financial planning services," global CFP board president Kevin Keller tells me from his organisation's swish offices on Washington, DC's infamously lawyer-ridden K Street.

"The long-held objective of our board has been to pursue regulation of planners," he says.

This lack of regulation means there is a wide range of individuals – from stockbrokers and salesmen to CFPs – who use the term "investment adviser" or "financial adviser" to describe what they do. Unlike Australia, however, a majority of these do not operate under a fiduciary duty but rather, a 'suitability' test.

The vast bulk of advisers or 'broker-dealers' are employed by the 'wire-houses' i.e. the large investment houses synonymous with Wall Street. These advisers sit somewhere between a stockbroker and a product-focused adviser in the Australian context. They are remunerated by commissions and – importantly – are regulated not by a government agency but by the self-regulatory body the Financial Industry Regulatory Authority (FINRA), which one US investment industry figure describes to me as "the devil".

But the stranglehold of the household name institutions on American advice is giving way to a plethora of new models, such as independent broker-dealers (ie, product-focused advisers with slightly more product flexibility) and various other hybrid models.

In addition, there has been a significant rise in the ranks of registered investment advisers (RIAs), also known as 'independents' or 'fiduciaries' due to their adherence to a legal best interests duty. Consultant Cerulli Associates estimates that the RIA market in the US "grew at an annualised rate of 8 per cent over the years 2004 to 2012, while other adviser channels declined by 1.2 per cent to 2.5 per cent".

The RIAs are accountable directly to the Securities and Exchange Commission – a scarier, better-funded ASIC – and operate small business fee-for-service firms specialising in personal advice. However, while the term 'independent' is used freely to group RIAs in the States, many are ultimately owned by insurance companies or investment houses, or even operate broker-dealer licences on the side.

CFP board president Kevin Keller describes this advent of a dual-licence model as "one of the most potentially confusing for consumers". Even though a fiduciary standard has now been introduced for at least some of the adviser market – and that RIA channel is growing – most consumers don't know whether their adviser has a fiduciary duty of care or not.

American consumers are also likely to be in the dark about educational qualifications – or lack thereof – since there is no government-enforced minimum standard to give financial advice.

However, while this might give RG 146 critics a heart attack, you have to take culture into account. American business believes unapologetically in 'caveat emptor' and personal responsibility.

In many ways the ultimate test for an American adviser is repeat business – the market decides. In our more motherly and protectionist culture, that approach may seem harsh – if not outright dangerous – but perhaps that lack of intervention and rules is necessary for innovation to thrive.

And while American advisers may not be keeping the education providers in business, there is no shortage of them innovating.

Rise of the robots

Unsurprisingly, much of that innovation is taking place in the technology area. From NASA's feats in space to the social media revolution, America has always seemed to be able to innovate and adapt to tech trends more quickly and successfully than others.

The robo-adviser trend – which in Australia is largely still at 'talk' phase – is no exception. But just because America has a decent track record in technological innovation, doesn't mean its advisers are unfazed by the rise of automated, technology-based asset allocation tools.

In the relaxed midtown New York offices of RIA firm Lenox Wealth, practice principals David and Greg tell us that at a recent networking event organised by custodian and consultant Charles Schwab, the robo-advice threat consumed debate.

"A lot of RIAs are really watching this closely and some are pretty worried," David says.

BNY Mellon Pershing Advisor Solutions (PAS), one of the most dominant custodians and practice management consultants to the RIA and broker-dealer markets, follows the rise of robo-advice even more closely than the firm's clients.

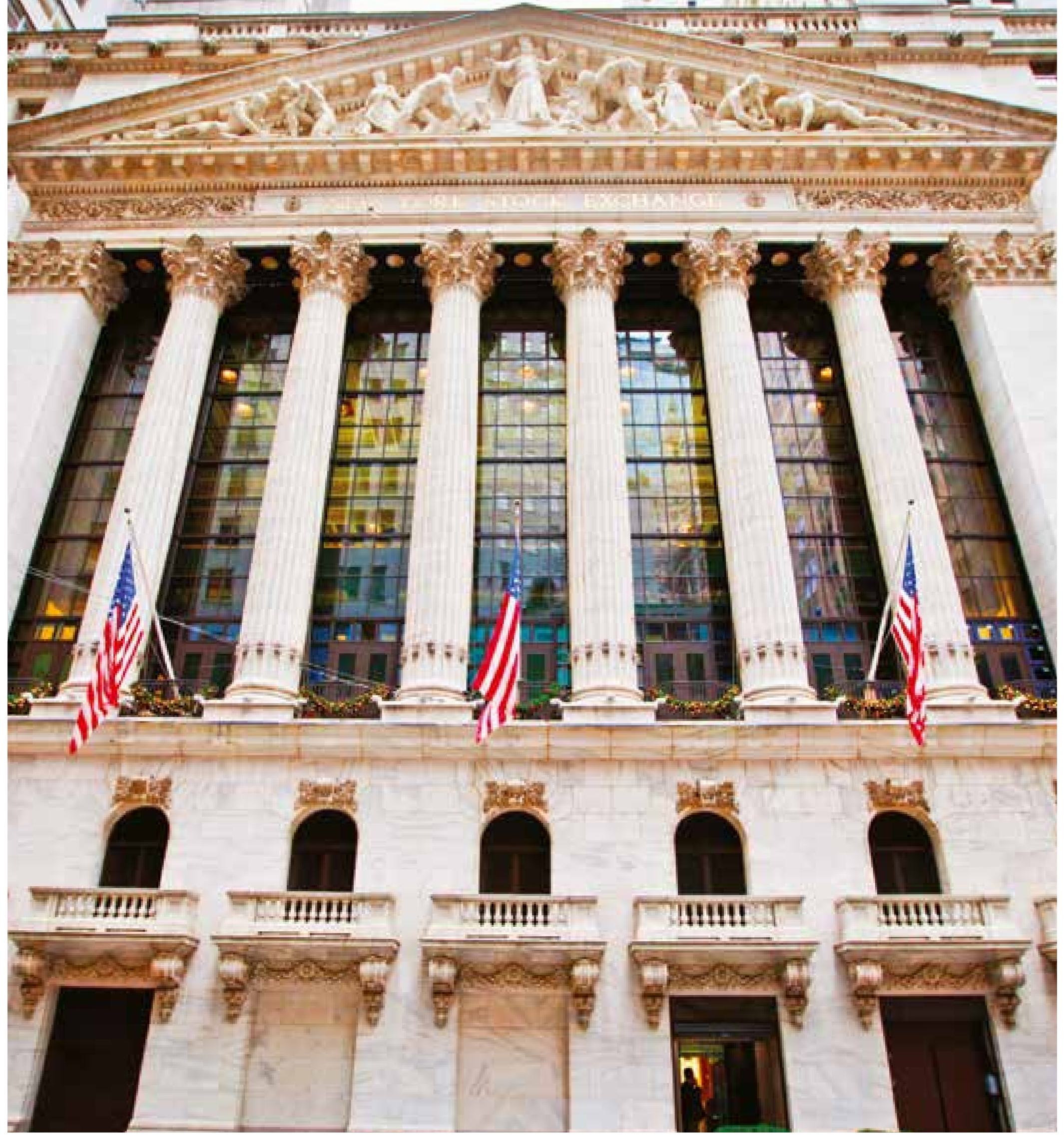
Speaking to us from the bank's sprawling Jersey City offices, PAS vice-president and technology consultant Robert Teaney tells us there are at least 10 different robo-adviser models emerging – with an undetermined number of actual websites or providers – anticipating that "in 12 months there will be even more".

With names like Personal Capital and Betterment, it is clear that these tools – which are up and running, with many turning a profit – are seeking to usurp the role traditionally played by human advisers.

Pershing executive Patrick Burke tells us, however, that rather than a threat, these tools are an "opportunity" for RIA firms.

In fact, many of the entrepreneurs behind these tools are actually RIAs looking to harness new ways of marketing their services to a younger generation of clients ahead of the all-important baby boomer retirement and 'generational wealth transfer'.

PAS receives several phone calls each week from people seeking advice on how to get into the robo-advice game, with two or three formal venture proposals hitting the Pershing desks each month – a vast majority from practising advisers.



8%

is the annualised rate of growth of the US-registered investment adviser (RIA) market, 2004-2012 (Cerulli Associates)

Those who are not willing to go the whole hog and develop fully-fledged robo-advice products are looking at these tools for inspiration on how to jazz up their website, such as providing customisation and social media sharing capabilities as part of the client review and performance process.

There is a wide range of services in operation that could loosely be described as robo-advice – ranging from DIY ETF construction tools to email-based advice portals with a real adviser at the other end. But all of them have some common ground in their underlying assumption that financial advice is something consumers want.

For Burke, the rise of robo-advice is a tech-age endorsement of what advisers do best, proving the enduring value of personal advice. Indeed, his view is that it is perhaps the robots that should be worried.

"Robo-advisers are fine for when the markets are up," he says. "The big question is what happens when they are down – will we see people realise what they need is more tailored, traditional advice?"

Divide and conquer

Given the quagmire of ownership structures, labels and the lack of education standards, in some ways, the US market is miles behind Australia's. Our discussion of independence and conflicts of interest is undeniably more sophisticated, and our consumer protection mechanisms more ... existent.

However, as the robo-advice and technology trend demonstrates, in other ways the American adviser appears to be miles ahead.

The most obvious of these is value propositions. Many US advisers have adopted business mantras that are an honest appraisal of their own business – and in the absence of any legal requirement to do so.

The consultants, executives and client-facing advisers we spoke to during the IP study tour all confirmed a similar trend.

Since the GFC – which American finance professionals refer to simply as '2008' – American advisers have diverged into two camps: 'asset managers' and 'asset gatherers'.

The former comprises those advisers who truly see themselves as portfolio construction experts, who focus on becoming quasi-fund managers and use the "sales and service guys" to focus on the clients.

The second group are those who are more outcomes-oriented and are focused on the client goals and objectives, largely outsourcing the investment component to an asset manager, 'ETF investment strategist' or investment house.

Unsurprisingly, a vast majority of advisers have tended to fall into the latter, and according to the consultants canvassed for this article, it is the asset gatherers who are truly thriving.

"Being an asset gatherer is completely scaleable," says Kevin W Quigg, head of global ETF strategy at State Street Global Advisors. "Perhaps some businesses can manage money and clients really well simultaneously, but it's rare."

Clients are fundamentally concerned with "customised service, not customised investments", he adds.

10,533

is the number of RIAs registered with the Securities and Exchange Commission as at April 2013 (Investment Adviser Association/National Regulatory Services)

When you speak to Australian advisers off-record, many will tell you they see themselves internally along these same lines, that is as either a client expert or an investment expert. But very few have taken that step further and communicated this value proposition to clients.

IP managing director Santi Burridge says the asset manager/asset gatherer trend is one of the most inspiring discoveries in the US.

"Every adviser needs to make the decision around whether they are brilliant at managing money or brilliant at managing clients," he says. "If I could enter every boardroom in Australia and make this the number one topic, I would."

The rise of asset gatherers is also evidenced by the growth of ETF investment strategists – a niche kind of asset manager that is working closely with asset gatherers across the country in a symbiotic and transparent relationship that consumers are warming to.

There are more than 115 ETF investment strategists working with BlackRock's iShares Connect Program alone.

But at the same time, this embracing of an outcomes-oriented approach is easier said than done for many Australian advisers, with dealer groups suspicious of some outsourced investment options and reporting technology seemingly skewed towards a focus on investment returns rather than client goals and objectives.

The US trends of technology take-up, honesty in value propositions and service outsourcing will have trouble taking root in an industry still run by the institutional dealer groups.

Having been acquainted with the task of implementing US-inspired trends for some time, Mr Burridge is blunt: "It is impossible for advisers to achieve their objectives in the non-independent environment," he says.

The rise of RIAs (as well as robots) in the US has brought greater attention to the burning question of what advisers do and where they add value.

Despite all the caricatures of American capitalism as unrestrained and heartless, it is those advisers who are investing in the human element of advice that are leading the way stateside.

As Kevin Quigg reminds us, "There's a reason they call it personal finance".

THE AUSSIE RESPONSE

After absorbing hours of content from American fund managers, advisers and practice management gurus, the members of the IP study tour met for some hard-earned reflection each evening. Here are some of the key take-outs

Santi Burridge
managing director, Implemented Portfolios

A difficult choice

"If there is one topic I have learned more about [than any other] from these study tours, it is the 'asset manager vs asset gatherer' debate. If I could enter every boardroom in Australia and make this the number one topic, I would. Every adviser needs to make the decision around whether they are brilliant at managing money or brilliant at managing clients.

If you are brilliant at managing money then build the team, processes and technology to rival the instos and take them on. Be proud of it and deliver seamlessly and consistently to all clients. Note: if you do this you are potentially reducing the value of your business though [since] if I am going to buy your business now, and it is predicated on your ability to pick investments, I am going to pay less as the client prescribes value to your investment skills. Without you, that – at least in the client's eyes – means less value just like any listed company. If key people leave, share prices go down.

The alternative and growing proposition in the US is partnering with investment managers to deliver scalable yet individualised investment portfolios to you and your clients, freeing you up to focus on what you do best, which is growing the business and working with clients. We heard time after time that these businesses were the ones growing as they realised early where their value lies and focused on what they do best. They are still proud of their investment service but clearly articulate they partner with a service to ensure the client is getting the best of both worlds."

Jackie Kirkwood
senior wealth adviser, Collins SBA

Communications conundrum

"The thing that really stood out for me was the work they are doing over here on value propositions. Every business we spoke to could clearly articulate their value proposition. If you asked me, I would need to think about it, whereas I think it should be automatic, and should not just be for advisers but able to be understood and articulated by all staff in the business, regardless of whether they have a client-facing role or not. After all, your value proposition is what really differentiates your business from others providing a similar service.

The other really interesting thing was the emphasis on marketing. We have always known it is important, and have good ideas on how to improve our brand and develop relationships with centres of influence. However, we don't have a dedicated resource in our business to ensure that these ideas are always implemented. I think it's timely that we now look at a dedicated marketing resource, whether internally or outsourced.

Another key take-out was the use of language, and I don't think we think enough about the actual words we are using and the way we communicate. So interesting to hear Pershing's research on use of the words 'holistic' and 'transparent', words that often creep into our discussions with clients, and how irrelevant they are if you're trying to create an emotional connection with the client."

Mark Nagle
head of wealth management, Treysta Wealth Management

Preparing for invasion

"The Treysta business has for some time recognised the threats and opportunities within the advice industry. The recent study tour to the US certainly confirmed the threats but it also provided validation in terms of the strategic thinking of the business to combat and manage the threats while taking advantage of the opportunities they create.

The term 'robo-adviser' is becoming more familiar in Australia, but these guys are coming more quickly and with more variety than most of the industry is prepared to accept. In a new paradigm, being referred to as the democratisation of investing, advisers that stay investment-centric will almost certainly fail. The robos will kill them off!

Those businesses and advisers that focus on advice and deeper client engagement will likely survive and thrive – these are the trends showing themselves in the US and they are in line with the business model and thinking at Treysta.

It was encouraging to see representatives from other businesses on the US tour embracing this approach. The industry in general needs to improve the way in which it communicates its shifting value proposition to its consumers. For too long, large institutions have driven the dialogue around fund choice, platforms and benchmark-related performance measurement, none of which are relevant to the outcomes of advisers' clients. One has to wonder: when these same institutions have direct-to-consumer investment models, how much longer will they need their expensive adviser distribution base?"

Craig Hill
partner, Halpin Financial Services

A strategic shift

"Going through my notes, one of the biggest take-outs was the point that what clients want is customised service, not customised portfolios – that really resonated with me. It really drove home that clients don't really care as much about those aspects at the end of the day. I have probably been guilty of focusing too much on the investment piece with clients because I feel comfortable doing it and because the performance reporting is set up that way. In the client review discussions, advisers need to focus less on investment reporting and more on lifestyle goals reporting.

"Also, the robo-adviser piece was really interesting – I think it's coming in a big way to Australia, maybe not immediately, but it is coming. I'm not sure what impact, if any, that will have on our businesses but it certainly could be a long-term threat to attracting younger, tech-savvy clients. I do know we need to start thinking about that generational wealth transfer and how we keep the families and younger generations on as clients."

Nick Davey
principal wealth adviser, Collins SBA

Passing the baton

"Two take-outs based on common themes from successful businesses in the US: firstly, to get the referral process right. In terms of referrals, it's not just about asking for referrals it's about making our business more referrable and giving clients more opportunities to refer – it's about the process.

Secondly: to really get right the generational wealth transfer. We have clients that have built up substantial wealth and we require a strategy to work with all the family members to continue to maintain and grow that family's legacy – by understanding and educating the various generations of the family in a way that appeals to them. So there's a fair bit of work we can do in terms of our website and being able to get our messaging across in an appropriate way for the younger potential clients."

"EVERY ADVISER NEEDS TO MAKE THE DECISION AROUND WHETHER THEY ARE BRILLIANT AT MANAGING MONEY OR BRILLIANT AT MANAGING CLIENTS"

Santi Burridge, Implemented Portfolios

Benjamin Pike
financial adviser, Treysta Wealth Management

Saying it out loud

"This week for me has been absolutely incredible. To come here and validate my complete faith in the IP process has been great. But the other great take-out is the value proposition thing. I can't wait to go back and cohesively work on articulating exactly what it is. It might sound a bit American, but maybe even blurting out the value proposition in internal meetings just so it's really, really clear.

I also want to take time to explain what we have learned to our referral network – our key centres of influence – and trying to get them to believe what we believe is best for our clients.

Confirmation in the way we actually convey performance back to clients is the other big one. The idea that the number doesn't matter, what matters is that we are here today and we are going to get you to [your goals and objectives]. What was ground-breaking for us is rapidly becoming more prevalent."

Anthony Isaac
director and principal adviser, AIP Wealth Management

Willing to self-promote

"It was evident that the major trend in the US has been to move away from pure investment management to wealth management. They have embraced the outsourcing of not only the core investment function but also many other non-client-facing tasks. This is a key strategy that I have employed in my business and it's great to have this reinforced.

To make this transition to wealth manager, Americans have put a lot of resources into positioning their value to clients. I really liked the American advisers' conviction and their belief about their value proposition. They seem to be far more adept at self-marketing than we are in Australia.

The robo-adviser industry in the US was another eye-opener. When compared, I believe that the human adviser relationship would win out every time. But the robo-adviser companies are employing sophisticated social media marketing strategies that may mean you never get the opportunity to meet the client to provide the comparison. Very scary stuff." ●