portfolio construction forum

Five opportunities for financial advisers to add value

Joe Tomlinson | Tomlinson Financial Planning | 06 March 2014

As competition in the financial advice business intensifies, advisers must focus on those activities that add the most value for clients.

When evaluating and explaining their own value, advisers should consider these five questions:

1. How do we measure adviser value added?
2. How can advisers better communicate their value-added message?
3. Should advisers worry about the threat from online or "robo" services?
4. How can advisers serve not just the wealthy, but also average people?
5. Which activities should advisers just outsource?

First, let's define a categorised menu of the areas in which advisers might provide services. The following menu focuses on clients in the retirement stage, which requires a wide range of services.

1. General Planning

General planning requires decisions to be made early in the planning process to set the structure for the overall plan.

- Affordability of retirement and when to retire
- Estimating retirement expenses
- Debt management, including credit cards, mortgages
- Social security timing
- How to structure an overall plan, including systematic withdrawals, floor/upside or time segmentation (buckets)
- When to adjust spending as conditions indicate

2. Investment selection and allocation

Investments can be split into selection and allocation categories, corresponding roughly to the "alpha" and "beta" investment-performance measures. Those who favor passive strategies will concentrate their efforts on the allocation menu items. Asset location refers to placing some investments in tax-favored accounts and others in taxable accounts. Withdrawal sourcing refers to selecting which types of accounts to tap first for needed retirement funds.

Allocation

- Basic asset allocation, including matching the asset allocation to spending flexibility and adjusting the asset

allocation for risk tolerance
- Strategic adjustments to allocations, both short term and long term
- Rebalancing
- Asset location decisions and withdrawal sourcing

Selection
- Individual security recommendations
- Funds and investment manager recommendations (including choice of active or passive approach)
- Alternative investment recommendations
- Individual securities trading

3. Products to consider

Building retirement plans involves not only how to allocate savings among different types of regular investments such as stocks and bonds, but also how much to allocate to annuity products that provide lifetime-income guarantees. The use of home equity to support retirement will become an increasingly important consideration for middle-income clients.
- Single-premium immediate annuities (SPIAs) and other annuity (or annuity-like) products
- Reverse mortgages or other use of home equity

4. Health related

Health is frequently ignored or avoided by advisers, but expenses for long-term care can devastate an otherwise sound financial plan. Advisers who provide full planning services need to work with clients to develop plans for dealing with health costs and potential long-term care costs, even if such plans require setting aside funds rather than purchasing insurance.
- Health insurance, including Medicare supplements
- Long-term care planning and insurance
- Use of government programs, including Medicaid

5. Damage control

I have included a damage-control category as a reminder that important value-added advice falls outside the traditional categories. Experienced planners can recall client situations where they stepped in to prevent disasters, and perhaps other cases where they wish they had spoken up.

MEASURING VALUE ADDED

In a January 2013 Advisor Perspectives article, Wade Pfau provided an overview of studies that attempt to measure whether advisers can help clients achieve improved financial outcomes.

Because such studies attempt to quantify objective metrics, they necessarily limit themselves to the items in the above menu that can be most easily measured. They are not able to provide a full picture.

Also, the assumptions used in such studies heavily influence the results. For example, the Pfau article referenced a David Blanchett and Paul Kaplan paper that measured the benefit of asset allocation advice by assuming a 20% stock allocation without advice and then showing the impact of raising the stock allocation. A different starting point would have produced different results.

Despite these limitations, these studies represent an important first step in measuring the variety of ways in which advisors can add value and set the stage for promising future research.

DESCRIBING SERVICES OFFERED

A Journal of Financial Planning opinion piece by Dan Moisand, in which he discussed his frustrations in trying to find a planner to recommend to a long-distance friend, revealed the challenges advisers face in describing their services. He mentioned websites that tell little about the specific planning services offered or advisers' philosophies, and too many vague selling points such as, "We can help you to meet your goals."

I have experienced my own frustrations using the search functions of various planner organisations when trying to help individuals find advisers. I have encountered numerous alarm bells in descriptive materials ("a former trader with a large investment bank"), but I too rarely have found meaningful descriptions of services offered.

Websites should articulate an adviser's philosophy in areas such as investments (active or passive), the use of annuities (Avoid or recommend? Which types?) and planning for long-term care (Insure or not?). Advisers need to avoid overwhelming potential clients with too much detail, but there is room for improved descriptive material.

COMBATING THE "ROBO" THREAT

In the past two years, a number of online investment-advice services have launched. The basic message in many of the offerings is, "Why waste money on advisors who have proven to be expensive, less than competent and biased in their recommendations? Good investment advice can be provided less expensively via computer."

These companies are mostly tech startups, and they typically offer automated fund selection and asset allocation, often recommending low-cost index funds. Their current focus is on clients in the accumulation phase; those services are not currently equipped to handle the complexities of retirement planning. It is likely that, as its clients age, a subset of those companies will extend their offerings to retirement advice.

Advisers have challenged the viability of these advice services in trade publications and discussion groups, arguing that computers will never be able to replace the face-to-face services that advisers can offer.

Advisers can respond to this challenge by performing a full analysis of the menu of services they provide. That can include an assessment of how computer power can be most effectively and efficiently combined with personal service. To date, the advice business, like many professional service businesses, has enjoyed the luxury of not having to focus rigorously on efficiency. The threat from the "robo" services will not cause advisers to suddenly become obsessed with efficiency, but it will apply some added pressure, and advisers should be prepared for that.

SERVING THE MIDDLE MARKET

Comprehensive planning services have focused mostly on the upscale population. Part of the reason is that costs associated with putting together a financial plan are mostly fixed, while the financial impact varies with the level of wealth. The amount of analysis required to do a retirement plan for a couple with $200,000 in savings is similar to what is required for a couple with $10 million. But, the type of analysis required will be quite different, so the planning approaches applied to upscale clients are not transferable to those with average levels of wealth. For the $10 million couple, much of the attention will likely be on wealth management, bequest goals and estate planning, while for the $200,000 couple, the plan will need to focus on getting by with limited resources, making the most of government super and possibly using home equity to fund retirement. The value-added elements are likely to be quite different.

The middle market has not been totally ignored by the planning profession. Some services have proved viable, such as planners who provide hourly-fee services. Others have failed, such as a modest monthly retainer for a combination of computer-based and personal planning services.

It may be feasible to build on the later model and find a new way forward. Keys to success will include keeping down the costs of preparing plans, focusing on elements in the menu that are most important to those with average wealth and efficiently providing personal assistance to complement online planning.

OUTSOURCING

I admit to a strong personal bias against investment outsourcing, mostly because it doesn't fit with low-cost passive investment management, which I favor. Even if I favored active management, I would still be reluctant to outsource such a core business activity.

Advisers should consider outsourcing to enhance some of the ancillary services they offer. Another candidate for outside support is planning for health-care and long-term care costs in retirement. In this September 2013 Advisor Perspectives article, I highlighted a service provided by actuary Jack Paul that provides customized projections and potential ranges of these types of costs. His service is based on an extensive actuarial research effort, which users are able to leverage.

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