A LITTLE DIRECTION

INDEPENDENT FINANCIAL ADVISORS HAVE BEEN GROWING BY CONVERTING SELF-DIRECTED INVESTORS, BUT CAN IT LAST?

WHEN DOES A SELF-DIRECTED investor need an advisor? More often than you'd think, says Craig Price, CFP, CTFA, of Florida-based Price Wealth Management.

"We serve a lot of very capable executives, now retired, but coming from an environment where they are used to managing their own assets. We also work with busy dual-income professional families, where they just don't really have the time do to it all by themselves, and they would like a co-pilot now and then," says Price. Price's firm offers a service called "Self-Directed Plus" to these independent-minded folk, a non-discretionary relationship where the clients make all the decisions but have full access to Price Wealth Management's advice and guidance whenever they need it.

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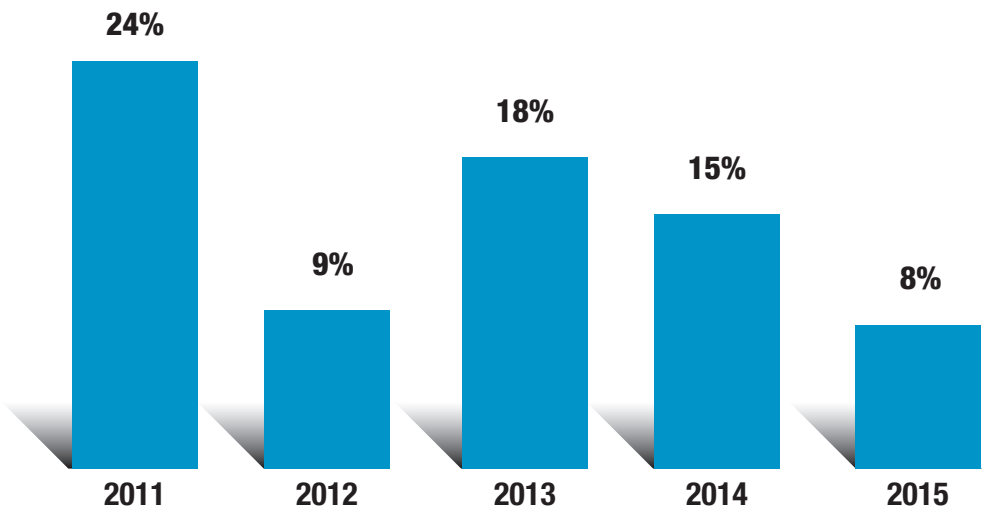
"Some of them are successful folks who had great executive careers and they are used to being in charge, but they realize they're not going to live forever. Sometimes their spouse might not be as confident or as able to take over if the one person who manages the investments gets sick or passes away. Going from a lightly assisted self-directed relationship to a full fiduciary relationship becomes a natural step as clients age."

Clients can also benefit from the additional knowledge and resources that a professional financial advisor brings — especially the ability to provide trust services that structure and protect wealth, reduce tax exposure and sustain family assets over multiple generations. Indeed one way to expand opportunities within the self-directed marketplace is to offer services that people can't readily perform for themselves, particularly in trust and estate planning.

Independents are Growing by Tapping Into the Self-Directed Marketplace

Price's experience mirror results from a new survey from InResearch sponsored by Pershing Advisor Solutions and the Ensemble Practice. The 2016 Financial Performance Study finds that conversion of self-directed clients is a bright spot in an otherwise slowing market for financial advisory services.

Figure 1: Revenue Growth Rate over the Past Five Years



Note 2011: 2014 data sourced from previous Moss Adams/InvestmentNews annual benchmarking studies

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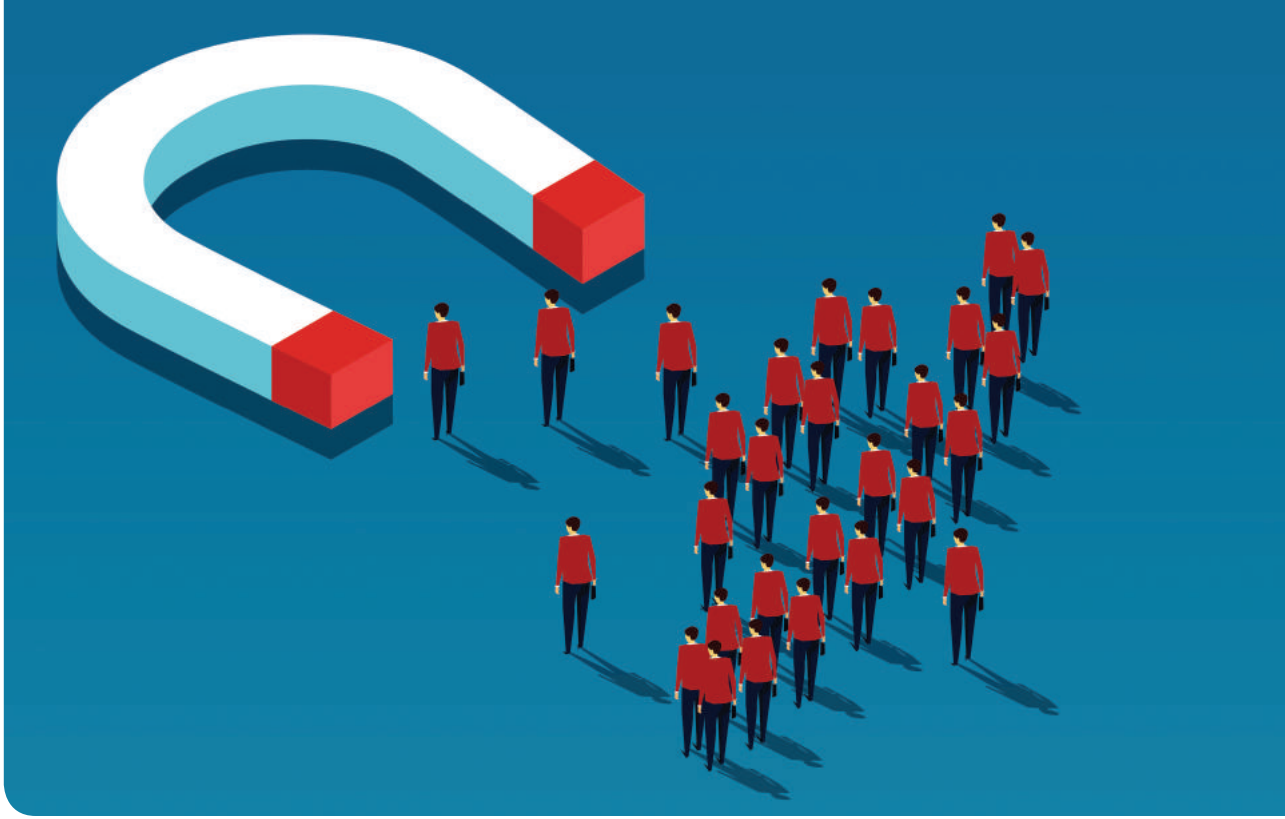
The survey, conducted between April 19, 2016, and June 22, 2016, collected data from 222 firms about their revenues, profitability, and an average size of relationships. Since the study has been conducted every year since 1991, the authors were able to identify historical trends.

The survey finds that the industry is still growing, though at a slower pace than in previous years. Revenue growth averaged just 8% in 2015, versus 14% in 2014 and 18% in 2013. More than half the firms surveyed (54%) missed their growth targets for the year. In a flat year, without much help from market appreciation, most firms found that it was more difficult than they anticipated to attract new clients and assets.

Not that the news was all bad. Though growth was slower, independent firms reached a peak in revenue and profitability in 2015, earning, on average, just under $4 million in revenues and achieving 26% profit margin.

Gabriel Garcia, a managing director at BNY Mellon's Pershing Advisor Solutions, sees slowing growth as a sign that the pool of self-directed investors ripe for conversion may be drying up, especially among the heavily targeted baby boomer demographic. "Wealth advisors have spent a significant amount of time cultivating new clients from the self-directed channel," says Garcia, "You'd expect that winning a new client who has never been served by a professional advisor is a little less difficult than competing for new clients who have already been served. So, the question becomes if we have cultivated the self-directed opportunity extensively for the last decade and a half, have we exhausted that opportunity?"



Garcia sees the financial advice business at a turning point, in which advisors will have to reorient their efforts to maintain growth. "Advisors who have been focused on boomers who already have wealth, will either need to pivot to a new demographic or begin to expand the opportunity set just beyond the self-directed channels," he says.

Four Ways to Expand the Self-Directed Opportunity

Given that growth is slowing, what can advisors do to attract additional relationships in the months and years to come? Here are three areas of opportunity in the self-directed market.

1.Harness the Power of People Plus Technology

One area of growth may be the integration of financial advice with the digital or robo platforms that have captured the attention of Gen X and Millennial investors. "What we are seeing is that some of the

most successful digital platforms are firms like a Personal Capital, who entered the marketplace with a people and technology approach," says Garcia. "This is a robo platform but coupled, from the get-go, with professionals, typically CFPs, who are assigned to the relationships to work and service those clients and help them make informed decisions."

The assisted robo model generates higher fees and attracts larger relationships than a pure robo platform. Personal Capital collects around 79 basis points in revenue per dollar invested versus a 25-30 basis point fee for platforms like Wealthfront and Betterment. Its average account size is over $200,000, as well, significantly larger than its pure robo competitors.

2.Support Without Taking Control

Craig Price developed another approach to serving self-directed investors when he noticed he was getting calls from people who needed occasional assistance, rather than a full-service relationship. For some, the entry point might be a four to six-hour fee-only consultation. Others might want additional insight on a fund or ETF they were considering. The common thread was though these investors had no interest in giving up decision-making power over their assets, they recognized the value of professional expertise.

Price's firm developed a service they call "Self-Directed Plus." Priced at 10 to 40 basis points, depending on account size, the service provides clients with advice and guidance when they need it – but leaves all investment decisions to the client.

If you want to remain in charge, but you want to have a professional to consult periodically to do all your paperwork, help you get online, and literally come to us when you want to tap into what we want to offer, that's when we offer "Self-Directed Plus,'" says Price.

Assets are held with Price Wealth Management's custody partner, Charles Schwab, giving Price and his team insight into the clients' portfolio challenges. And because the assets are already held there, it becomes relatively easy to convert self-directed plus accounts into full-service ones when and if the need arises. "Usually a life event is a catalyst for moving to a full-service relationship," says Price. "The death of a spouse is the most extreme catalyst. Sometimes it's just a change in lifestyle, going from working to retired, to we're going to go do our bucket list for the next couple of years and we don't want to have to pay attention to our money. So, they'll delegate full discretion to us. We basically just turn on a switch. I'm being metaphorical, but it's a very easy transition because we have custody of their assets with us and we just assume a higher level of responsibility, as fiduciaries, at that time."

Currently, Price says that "Self-Directed Plus" clients are his fastest growing business segment, after full-service retirees, and he has not noticed the slowdown that the Pershing survey tracks. "The reason we developed this offering is we kept running into people who were still managing their own assets even into their late 70s and 80s and had no plan for their surviving spouse," says Price. "I think there's a huge supply of people that are in denial about their mortality. Nobody wants to think about when I'm gone, who's going to take care of my spouse? Once they face that reality, they're like, yeah, this is a pretty smart solution."

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Garcia says that Price's service sounds like a smart way to capture self-directed relationships. "It sounds like he's built, for lack of a better term, a farm system. He is offering a very basic set of services and support to build a relationship that will hopefully grow over time, as complexity or life transition or other decision points occur. When that happens, they will have a familiarity with the brand, with the individual, with the platform, and it's a natural transition. I think any marketing strategy that has a glide path to move through the experience and the level of support and professional advice delivered, that seems to make sense," he states.

However, Garcia says there are other ways to achieve the same ends. "We have seen firms use the financial planning aspect of their business as a way to engage with families," he says, adding that fee-based planning engagements can deliver value and expose the planning needs that may eventually make a full-service relationship attractive. "So, I don't think there's a silver bullet to what is the best way, but any way to engage with a family to begin to get to know them and them get to know you, whether through a planning only experience initially or a basic set of support services to a self-directed advisor, certainly engenders trust and credibility over time," he adds

3. Connect with Next-Generation Investors
The pool of baby boomers who have never had a wealth advisor may be thinning, but look beyond them, and a whole new generation of self-directed investors is coming. Gen Xers are currently in the prime age for asset accumulation, while Millennials are just beginning their journey towards financial security. Advisors who can pivot to serve younger generations, says Garcia, will have a much larger pool of potential prospects.

However, Garcia adds, it will take some adjustment to reach them. "If you look at the next generation of the core client base, the people who are now entering the phase of life that requires professional informed decisions, they've grown up in a world where access to information, validation of information, and participatory experiences are the norm. They want to be part of the process," he says.

Younger clients want much more interacting with their advisors, though not necessarily through traditional channels. About a decade ago, Garcia notes, Julia Littlefield's "Economics of Loyalty" survey found that baby boomer clients wanted to be contacted by their advisors, on average, about 16 times a year. "That's a phone call once a month, an annual review, a quarterly newsletter, and maybe a golf outing," he says. "The younger generation is looking to engage or interact 16 times a month.

I HAD PREVIOUSLY OFFERED INVESTMENT ONLY ADVICE AND WOULD FOLLOW-UP EITHER ONCE A YEAR OR EVERY SIX MONTHS DEPENDING ON THE SIZE OF THE PORTFOLIO FOR AN HOURLY FEE

That sounds like a lot of interaction, but Garcia cautions that very little of it has to be face to face. "Meaning they want to log in to pull down a performance report on what happened yesterday. They want to log in and see a video of their advisor or chief investment officer sharing some insight or perspective on markets. They want to text. They want to read a blog. They want to engage with you in multiple ways through digital channels and physical channels. All of those touch points are valuable and necessary," he says.

That's where robo platforms can be so helpful, offering digitally savvy clients access to rich, constantly updated content that they can access whenever they want. Price says that his firm uses an online wealth management platform called eMoney, which allows them to track their portfolios in real time through a digital interface. "We give eMoney capability to our millennial clients and even some of our more tech-savvy older clients who want to aggregate all of their assets into one financial home page for themselves," he says. "We don't have a lot of clients in that 25-45 category unless they are adult children of our older clients. The ones we do have are particularly interested in the self-serve, robo-type of service, where they're in the driver's seat, but they want to tap into some additional experience, especially when markets have a lot of volatility."

4. Add trust services to your practice

One way to attract self-directed investors is to offer services that are difficult, if not impossible, for them to do themselves, such as trust and estate planning. Adding trust services can increase advisors' value to their most attractive clients and prospects, high net worth and ultra-high net worth individuals and families.

Consider that there are now more than 10 million households in the United States with assets over $1 million and more than 1 million households with net worth between $5 and $25 million.[1] Many of these high net worth investors are entering a critical period for estate planning, the end of working life and the beginning of retirement. The baby boomer generation, representing roughly 20% of the American population is expected to have accumulated some $20 trillion in retirement assets by 2020; according to recent analysis by LIMRA.[2]

The transfer of those assets over the next several decades represents an enormous opportunity for financial advisors with sophisticated trust company services for estate and charitable planning. It is also a risk for advisors who do not have the benefit of the asset 'stickiness' that comes with being able to offer trust services. That's especially critical as clients in the baby boomer generation begin to pass on and leave assets to family members. This massive asset transfer process typically entails a change in control and decision making. A recent survey in Financial Advisor Magazine found that 70% of widows had fi red their advisors within a year of the husband's death.

A Tough Market Segment

Not all advisors are enthusiastic about the self-directed market, where prospects tend to be price conscious, headstrong, and hard to convert to full-service clients. Scott Winkler, CPA/PFS, CFP® of Winkler Financial Planning in Norcross, Georgia, says he stopped offering stand-alone advisor for self-directed investors a few years ago.

[1] Spectrem Group's Market Insights Report 2015, cited in Reuters http://www.reuters.com/article/2015/03/10/idUSnMKWyVv63a+1d0+MKW20150310

[2] "Boomers will have $22T in Retirement Assets by 2020," ThinkAdvisor, February 16, 2013. http://www. thinkadvisor.com/2013/02/06/boomers-will-have-22t-in-retirement-assets-by-2020

"I had previously offered investment only advice and would follow-up either once a year or every six months depending on the size of the portfolio for an hourly fee. I found that most of the clients eventually stopped following up. There are probably multiple reasons including procrastination on their part or the fact that many firms such as Vanguard and Fidelity would offer something similar for no charge depending on the size of their accounts. The followupwas much better when I prepared a financial planfor the client," he explains. "Typically, self-directed investors do not see the benefit in having their accounts managed. They do not see the benefit in making a lot of changes so a six-month or annual follow-up is sufficient for them."

"I do not consider self-directed investors as a growing market. The investment advice is only a portion of a complete financial plan. With low-cost robo-advisors, free advice from some brokerage firms, investment news-letters with model portfolios, and target retirement funds there does not seem to be much of a market for financial planners," he adds. "I have converted some of my self-directed investors to a managed account over time. This is typically the case when their portfolio grows in size and they no longer feel they can manage it properly."

Challenges and Opportunities in a Shifting Marketplace

Garcia says that the slowing growth trend uncovered in the Financial Performance Study has continued this year, and he expects it to persist long-term due to changing demographics. "We're seeing a shift among advisors' core client base, who are moving from accumulators to de-accumulators," he says. "The average age of clients is 62 today. They are moving into retirement, engaging in philanthropy, spending money on experiences, and living off their investments – in short, they're taking out more money and not putting money into their accounts. That's changing the economics of the wealth management firms. It's driving a need to invest in technology, marketing, and talent development to create the capacity to continue to grow."

Yet opportunities persist for firms that pursue the self-directed marketplace — by integrating technology and human relationships, by seeking out investors transitioning from full independence to an assisted model, by offering sophisticated products like trusts and estate planning that self-directed investors can't replicate on their own and by reaching out to younger generations now ready for an advisor.

Perhaps the single most important step, though, for advisors targeting the self-directed marketplace is adding trust services. Trust services are becoming increasingly popular among the wealthiest families and individuals because they control the disposition of assets to beneficiaries, assign a high level of fiduciary responsibility and ensure a solid structure for future safety and growth. If properly constructed, trusts can carry out asset disposition in a tax efficient way.

Trust companies also have the ability to structure wealth distribution in sophisticated ways, using a variety of trust vehicles, managing estate taxes, family business interests, charitable gifts and intergenerational planning. Trusts often contain complex dispositive provisions governing the most tax efficient (and beneficiary attentive) methods of transferring a broad variety of assets, including unique interests such as closely held businesses, family heirlooms, farm land, customized annuities or limited partnerships and different methods of charitable giving. Trusts can also contain language dealing with longer term intergenerational planning.