WEALTH MANAGEMENT IS NOW A "DESIGN" INDUSTRY

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WEALTH MANAGEMENT IS "IN."

Banks, wire houses and RIAs are pouring resources into developing competitive wealth management offerings, hoping to capture a larger share of this rapidly growing marketplace. And many of these firms are going about it all wrong.

How?

By focusing too much on *products* and not enough on the *client experience.*

There is a reason people shell out premium prices for a cup of coffee at Starbucks, rooms at the Ritz-Carlton, Apple products and trips to Disney World. Yes, these firms offer excellent products and, yes, they all deliver good service, but the reason these firms are so successful is they understand their customers do not keep coming back to buy a *product*—they are paying for an *experience.*

Wealth management is evolving in the same direction.

The value proposition decreasingly focuses on products or service, which are assumed or taken for granted. Increasingly, the emphasis is on the quality of the advice, the level of expertise delivered, the ease with which information and service can be accessed—the wealth management *experience* enjoyed by the client.

Here is a summary of how high net worth (HNW) investors and families value their wealth management solution, according to research conducted in 2022 by Vanguard[1]:

	Module	Typical value added for client (basis points)
Suitable asset allocation using broadly diversified funds/ETFs	1	>0*
Cost-effective implementation (expense ratios)	2	30
Rebalancing	3	14
Behavioral coaching	4	0 to > 200
Asset location	5	0 to 60
Spending strategy (withdrawal order)	6	0 to 120
Total return versus income investing	7	>0*
Range of potential value added (basis points)		Up to, or even exceed, 3% in net returns

* Value is deemed significant but too unique to each investor to quantify.

This paper summarizes several of the trends driving the HNW marketplace today, with a particular focus on commoditization and true differentiation. It also suggests what a successful wealth management solution needs to offer, and why more firms are finding that outsourcing provides them with the best opportunity to remain competitive and deliver an appropriate wealth management experience.

[1] See: https://advisors.vanguard.com/iwe/pdf/IARCQAA.pdf.

To deliver a successful wealth management solution in today's competitive marketplace, a good place to start is with the idea of the 3 Ps model (**Platform, Process, People**), an adaptation of the "people, process, technology" framework applied in many industries[2]:

PLATFORM

A competitive solution begins with the wealth management platform offered to clients. An appropriate framework here is the solution offered by many of the leading wealth advisory firms. These firms rarely compete based on product or price—they compete based on the quality of the advice they provide and the level of service they deliver.

The advice these firms offer can be segmented into main categories—investment consulting services and a broadly defined suite of wealth management services tailored to the needs of the client base.

Investment consulting has its historical roots in the institutional world, where pension funds, endowments and foundations have long sought objective advice on how to structure and implement an appropriate investment portfolio.

In the HNW space, the "deliverables" of investment consulting can be summarized broadly as follows:

- INTEGRATED WEALTH PLANNING
- INVESTMENT POLICY STATEMENTS
- ASSET ALLOCATION AND "ASSET LOCATION" PLANNING (TAX EFFICIENCY)
- CUSTOMIZED PORTFOLIO CONSTRUCTION
- MANAGER SEARCH AND SELECTION (FOR BOTH TRADITIONAL AND ALTERNATIVE INVESTMENTS)
- CONSOLIDATED PERFORMANCE REPORTING

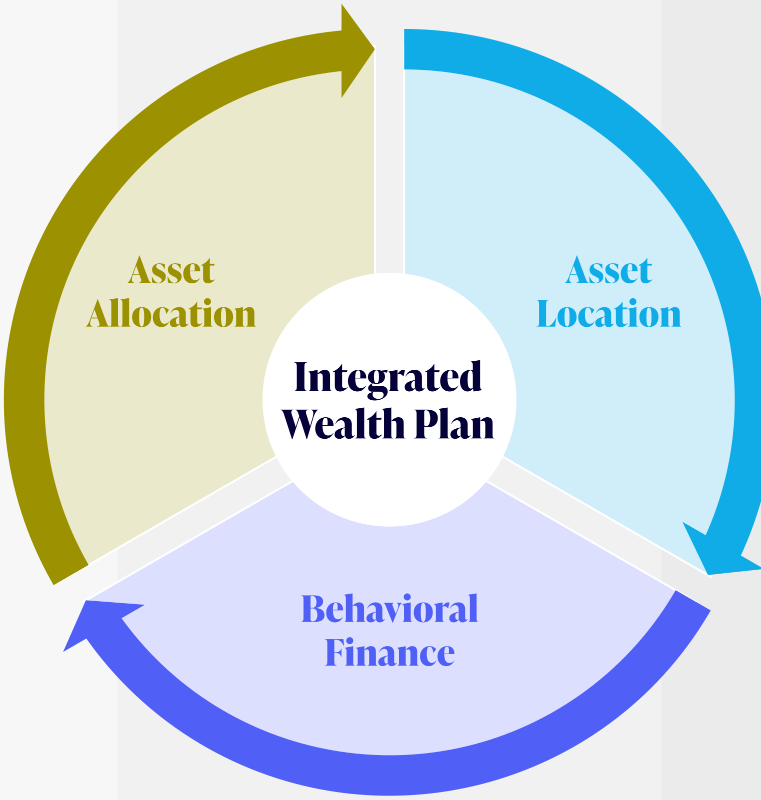
Most of these terms are self-explanatory, but the phrase "integrated wealth planning," made popular by industry thought-leader Jean Brunel,[3] deserves further discussion.

The term refers to the fact that the institutional consulting model, with its heavy focus on unemotional asset allocation in a world where the time horizon theoretically is infinite and taxes don't exist, is flawed when applied to tax-paying humans.

[2] See, for example: https://www.smartsheet.com/content/people-process-technology.

[3] Jean Brunel, Integrated Wealth Management: The New Direction for Portfolio Managers, Euromoney Publishing, 2002. See: https://www.amazon.com/Integrated-Wealth-Management-Direction-Portfolio/dp/1855649233.

Brunel suggests that when dealing with individual investors, the concept of an "optimized" portfolio does not exist; instead, investors and their advisors are on a perpetual "path to optimization."



* Adapted from Jean Brunel, Brunel Associates.

Think of integrated wealth planning as a three-legged stool. One leg is the traditional concept of asset allocation—diversifying investments across multiple asset classes in such a way as to minimize the risk of the portfolio for an expected or desired level of return.

Many advisors today still "sell" asset allocation as the end-all and be-all of investment planning. But traditional asset allocation ignores two inconvenient aspects of dealing with individual investors—they pay taxes, and they frequently behave irrationally with respect to their wealth.

To factor in these components on the path to optimization, wealth managers need to incorporate the following:

- **ASSET LOCATION:** This refers to the integration of appropriate estate planning vehicles to minimize the taxes paid on the overall investment portfolio. Estate planning is often pigeon-holed to minimize wealth transfer taxes as money moves through generations. But proper use of estate planning and other tax-deferred or tax-minimization vehicles (IRAs, 401(k)s, LLCs, FLPs, trusts, etc.) can also reduce income taxes paid along the way. By placing different types of investments within various tax-deferred and estate planning entities, investors can increase the inherent power of compounding within the portfolio. Many wealth advisors tend to focus on creating the "perfect" investment portfolio—but the truth is that, in the long run, good tax and estate planning will trump good investment planning every time.

- **BEHAVIORAL FINANCE:** The field of behavioral finance, which is essentially the study of why perfectly rational investors frequently make wildly irrational decisions with respect to their money, has been around for 20–30 years, but it is only in the past several years that the wealth management industry has attempted to turn the theory into practical applications. Today it represents one of the most talked-about and written-about concepts in the industry. With respect to the path to optimization for individual investors, it can be thought of as developing a better understanding of the investor's emotional make-up and frame of reference with respect to their wealth and using that understanding to create investment portfolios that not only "work" quantitatively, but that are comfortable for the investor from an emotional perspective. Most wealth advisors have experienced the frustration of creating an investment plan for a client that is never implemented, or that is abandoned at the first unexpected event. Many times, this is because the investor simply could not "buy in" to the plan from an emotional perspective.

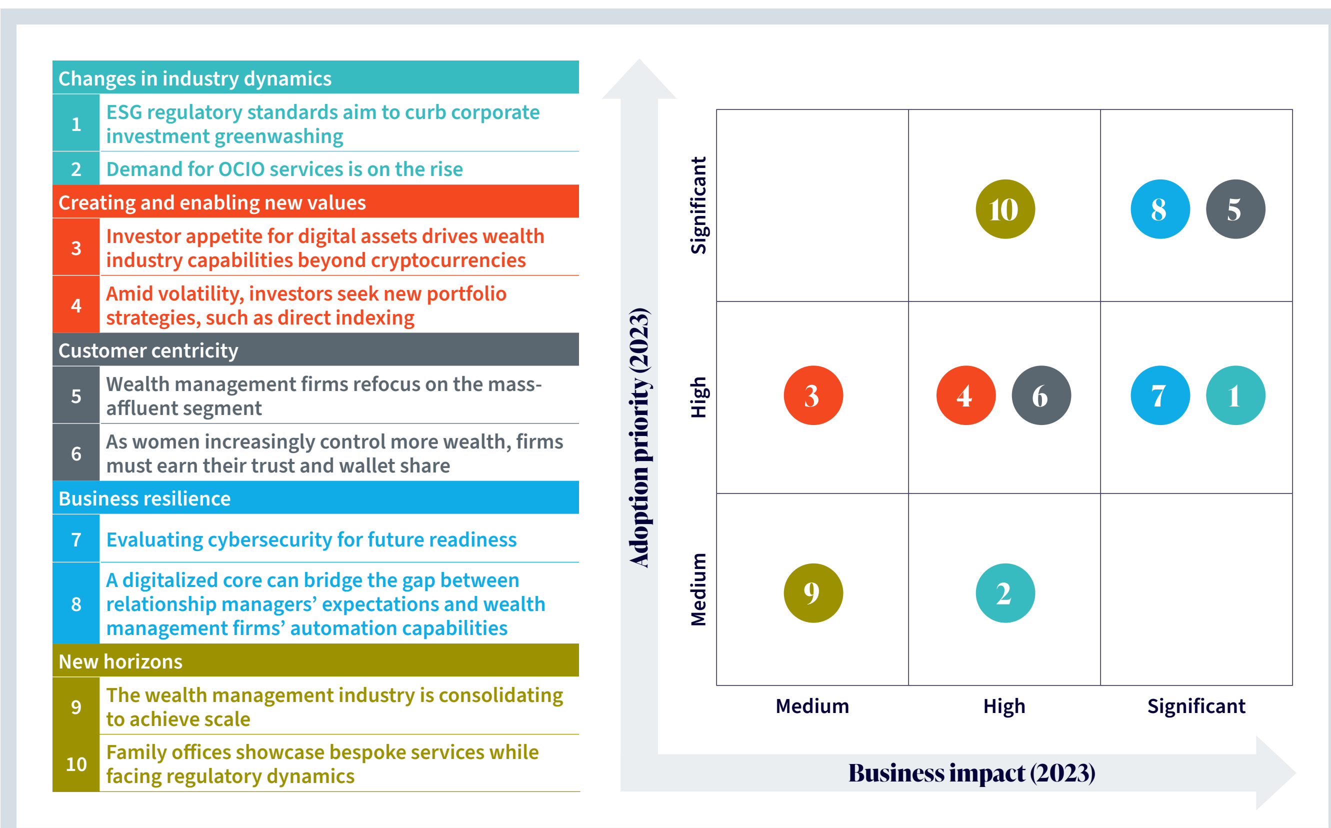
Successfully integrating asset allocation and asset location into an overall wealth plan that fits the emotional frame of reference of a specific client is clearly not a commodity—it is a critical step in delivering a differentiated wealth management experience.

According to annual wealth management surveys from Capgemini and PwC,[4] in addition to investment consulting, the successful wealth management platform must also deliver a broad array of services tailored to the needs of the affluent marketplace, such as access to:

- Alternative and private investments
- Digital assets and digitized technology
- ESG and impact strategies
- OCIO (Outsource Chief Investment Officer) services
- Attractive loan rates and credit services
- Managers and custodians, with negotiation price
- Top-quality estate and insurance planning
- In-house or external high-quality trust services
- Internal or external bill paying, record keeping and tax preparation

Here is how Capgemini sums up wealth management trends as we move through 2023 and beyond:

Top Trends in Wealth Management 2023: Priority Matrix



Source: Capgemeni Research Institute for Financial Services Analysis, 2022.

[4] See *Wealth Management Top Trends Report 2023*, Capgemini: https://prod.ucwe.capgemini.com/wp-content/uploads/2022/12/Top-Trends-Wealth-Management-2023-1.pdf, and *Next in Asset Management 2023*, PwC: https://www.pwc.com/us/en/industries/financial-services/library/asset-wealth-management-trends.html.

The key word for all these services is "access." It is not required—and often not desirable—for a given firm or practice to deliver these services through internal or captive channels. As wealth management becomes more complex and customized, many firms are developing expertise in specialized and niche services.

The comprehensive platform described above is necessary but not sufficient for success—these services are not automatic differentiators in today's marketplace, but *not* offering them is, or soon will be, a *negative* differentiator.

PROCESS

The second leg of delivering a successful wealth management solution is creating an appropriate process for delivering the platform. The traditional model of salesperson handing off to a portfolio manager is exactly the wrong model to deliver the platform described above.

To its credit, the wealth management industry is moving in the right direction on this front. Increasingly, practices are focusing on building *teams* with different areas of specialization to service a common client base, and compensation structures are changing to reward professionals who deliver the entire practice to the client, and not just their area of expertise.

This model is illustrated below. Some firms have made great strides in this direction; others have a way to go.

Putting the right process in place, of course, requires more than just changing the organization chart and compensation structure. Many firms and practices today place a heavy emphasis on client attraction (i.e., bringing new clients in the door) but have little to no formal process in place to retain the clients already in the house.

From a profitability perspective, the "dirty little secret" of wealth management is that it generates lower operating margins than other types of firms in the broader financial services industry. It historically was not as scalable (though that is changing due to technology advances and firm consolidation), it requires more qualified and higher-priced professionals to deliver successfully, and the cost of dealing with external managers and service providers can be more expensive than in-house solutions.

To be successful, then, wealth managers need to make heavy investments in technology and place an increasing emphasis on operating efficiency and bottom-line growth—not just top-line revenue or growth in assets under management.

This point also highlights an ongoing difficulty for publicly held banks and financial service providers in providing an appropriate wealth management solution. It is more profitable (both absolutely and on a recurring revenue basis) for firms to sell captive product. So, while some practices may recognize that offering an open architecture solution (that is, offering both internal and third-party solutions) is more appealing to clients, it may be the wrong solution for shareholders. This is known as the "agent/fiduciary conflict," and it is not easy to resolve.

A final aspect of process is the cultural one.

No amount of change to the product mix or delivery system of a wealth management offering will succeed if the firm does not focus intensely on creating a corporate culture and mindset that aligns business practices and behavior with the overall business strategy.

PEOPLE

The final aspect of delivering a successful wealth management solution, and perhaps this should have been listed first, is people—and there are several aspects to making sure the right people are in place.

The BDO/CRM Conundrum

Industry and psychological research suggest that roughly 10% of wealth management applicants possess the appropriate personality and psychological profile to be successful business development officers (BDOs).

“Making it rain” is a rare and valuable skill.

At the same time, roughly 50% of candidates have the appropriate make-up to be successful client relationship managers (CRMs). Statistically, then, only (0.1 x 0.5) percent—one applicant in 20—has the goods to excel at both client acquisition *and* client servicing.

The implication is clear—wealth management firms must hire and retain both types.

Today, successful CRMs must be able to not only deliver the firm’s solution in a seamless and professional manner, but they must also be able to harvest internal leads that come their way from other specialists within the organization and develop strong relationships with center-of-influence referral sources.

On the flip side, the stereotype of the successful BDO is an extrovert with strong empathy, well-developed knowledge/understanding of the firm’s offering and value proposition, high “EQ” (emotional quotient), discipline/persistence, and highly developed interpersonal skills, combined with a high tolerance for failure. Those traits may still be necessary, but, given the increased relationship management responsibility implicit in delivering an integrated wealth management solution, they are no longer sufficient.

Credentialization

One manifestation of the increasingly complex solution demanded by HNW clients is that it becomes increasingly difficult to be a generalist—wealth management is an industry well down the path of specialization and niche players. Even a CRM whose primary responsibility is to marshal specialists to meet client issues needs more than a casual chat level of expertise.

The result? The industry has seen an explosion in “credentialization” as wealth advisors pursue advanced degrees and industry certifications to remain competitive.

Consider the following partial list of programs and certifications now available:

- The Certified Investment Management Analyst (CIMA), Certified Professional Wealth Advisor (CPWA) and Retirement Management Advisor (RMA) certifications offered by the Investments & Wealth Institute (IWI)
- The Chartered Financial Analyst (CFA) certification offered by the CFA Institute
- The Certified Financial Planner (CFP) certification offered by the Certified Financial Planning Board (CFP Board)
- The Personal Financial Specialist (PFS) certification offered by the American Institute of CPAs (AICPA)
- The Certified Trust and Financial Advisor (CTFA) designation offered by the American Bankers Association (ABA)

This list does not even consider internal "university" and certification programs offered by individual wire house and banking firms. Many of the larger wire houses, for example, have instituted rigorous internal certification programs that financial advisors must complete before they are allowed to work with HNW clients.

This is not a fad—the emphasis on advanced education and specialized training will only increase and will soon become an industry-wide requirement for advancement.

Conversely, firms that do not offer appropriate certification and education opportunities for their advisors will find it difficult to retain their top talent who have embraced this new paradigm and demand training as part of their employment package.

Framing the Wealth Management Experience

Advisors know they often need to wear multiple hats to deliver a superior wealth management solution. These varied roles are critical to running their business. But the burden can make an advisor feel like the business is running them.

This begs the question: Which hats are most important? A framework based on Maslow's hierarchy of needs can help answer this.[5]

Maslow's hierarchy of needs helps understand human motivations. We've adopted Maslow's pyramid into an "Advisor Value Pyramid." This illustrates the value clients put on the products and services advisors offer.

With Maslow, the functional needs at the bottom of the pyramid are food and shelter. With investors, the functional needs are related specifically to their portfolios. Once these needs are met, they look to advisors to help meet their "emotional" and "life-changing" needs.

Research suggests that, with an advisor's in-depth knowledge of their clients, *they are the only ones who can deliver these emotional and life-changing values.* This is in stark contrast to functional needs, where leveraging software and third-party expertise is more practical.

Using Maslow's hierarchy of needs as a framework, advisors should assess where their time is best spent within the Advisor Value Pyramid. The goal is to offload as many functional-level hats as possible and spend more time delivering the emotional and life-changing services clients value most.

For example, many advisors use model portfolios to satisfy functional needs. Leveraging the expertise of third-party managers achieves the clients' functional needs of "grows my financial portfolio" and "provides a variety of investment strategies" as referenced in the Pyramid.

[5] Maslow's hierarchy of needs is a motivational theory in psychology consisting of a five-tier model of human needs, often depicted as hierarchical levels in a pyramid. See, for example: https://www.simplypsychology.org/maslow.html.

The Argument for Outsourcing

All the trends identified and discussed in this article point to an inevitable conclusion—outsourcing of wealth management services will increase dramatically in the coming years.

Consider the benefits of outsourcing in comparison to the alternative methods for creating a successful wealth management solution (i.e., building it organically or buying it via acquisition):

- It allows firms to focus on business development and client relationship management, while still delivering best market practices
- Partnering with proven providers allows a wealth management firm or practice entering this highly competitive space to "hit the ground running"
- It may maximize net profitability by reducing operational, staffing and compliance requirements
- It allows the firm's internal focus to be on professional development and education
- It allows the RIA or wire house practice to quickly evolve away from sub-optimal legacy systems and service platforms

Consider the findings of several industry surveys:

- Advisory focus on "the client experience" results in a 93% higher median client size[6]
- Advisors who outsource at least 90% of their assets save an average of 8.4 hours per week on investment management[7]
- 90% of investors welcome third-party models in their portfolios; 70% of investors believe third-party models will help improve their portfolio performance; 75% fewer investors would consider leaving their advisor if they used third-party models[8]
- More than 50% of advisors currently outsourcing their investment management have reported a decrease in operating costs since they began outsourcing, with 40% seeing declines in costs of 5% or more[9]
- Over 80% of advisors reported both stronger client relationships and increased client retention as a direct result of outsourcing; 67% of all advisors increased the number of client referrals[10]
- Advisors who outsourced experienced financial benefits: 77% reported an average of 27% growth in assets; 72% reported an average of 26% higher personal income; and 67% reported an average of 17% lower operating costs[11]
- Advisory practices that dedicate 70%+ of their time to client service and asset gathering report 3.5 times the number of new clients and twice the asset growth of those that don't[12]

6 See: https://www.thinkadvisor.com/2018/12/20/advisors-focused-on-client-experience-have-93-bigger-clients-cerulli/.

7 "Impact of Outsourcing" whitepaper by AssetMark and © 2020 BlackRock, Inc. All rights reserved. Quoting: Cerulli Associates, "U.S. Advisor Metrics 2018: Combatting Fee and Margin Pressure." Time savings estimation assumes 20% time savings x a 45-hour work week x 50 weeks per year = 450 hours saved.

8 WisdomTree proprietary research: https://www.wisdomtree.com/investments/mac/client-research.

9 See: https://f.hubspotusercontent40.net/hubfs/2512747/Impact%20of%20Outsourcing%20-%20AssetMark%20Study.pdf.

10 Ibid.

11 Ibid.

12 See: https://docplayer.net/42941077-The-value-of-time-quantifying-how-client-focus-increases-the-value-of-your-business.html.

The Wealth Management Experience

The current and future state of the wealth management industry can be summarized as follows:

- HNW families increasingly demand an objective and consultative wealth management solution
- There are very few products and services that cannot be outsourced effectively
- It will be increasingly difficult to differentiate yourself based on investment product, as there are so many institutional-quality outsourced solutions available
- Technology improvements will allow an ever more seamless delivery of outsourced products and services
- Niche players will continue to develop as outsourced service providers—specialization means differentiation and higher margins

Wealth management is now in a post-product, post-service stage of development. Wealth management is now a *design* industry. Think of Starbucks, Disney, Apple, Whole Foods, Nordstrom, the Four Seasons and Ritz-Carlton hotel chains—what do they have in common?

Do they sell a quality product? Absolutely. Do they deliver quality service? Of course. But what sets them apart—and allows them to charge a premium price—is the overall *experience* clients enjoy in dealing with these firms.

So how does this translate to the wealth management industry? What is the appropriate wealth management experience? In a highly competitive marketplace, where products are widely and cheaply available, and where everyone claims to offer excellent service, offering a wealth management experience means having the most talented people operating as a team in the most conducive environment and delivering "best of strategies" solutions to specific client needs.

The wealth management practice that can capture this experiential magic in its wealth management offering will be the firm that succeeds.

Want to learn about how WisdomTree can help? Visit WisdomTree.com/Portfolio-and-Growth-Solutions for more information or email wtpg@wisdomtree.com.

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