ENVESTNET®

The Fiduciary Opportunity

The Future is Now

After nearly a decade of trying, the Department of Labor (DOL) finally rolled out its Fiduciary Rule on June 9, 2017—though only with a partial implementation. The Impartial Conduct Standards went into effect and this means advisors and their firms must put their clients best interest first. The fiduciary standard is certainly here to stay and probably for taxable accounts as well. Firms should already be meeting the Impartial Conduct Standards for retirement accounts and be preparing for taxable accounts soon.

However, the headlines following the 18-month delay to major portions of the Fiduciary Rule have cast significant doubt on the future of the regulation that aimed at protecting retirement savers from hidden fees and conflicts of interest.

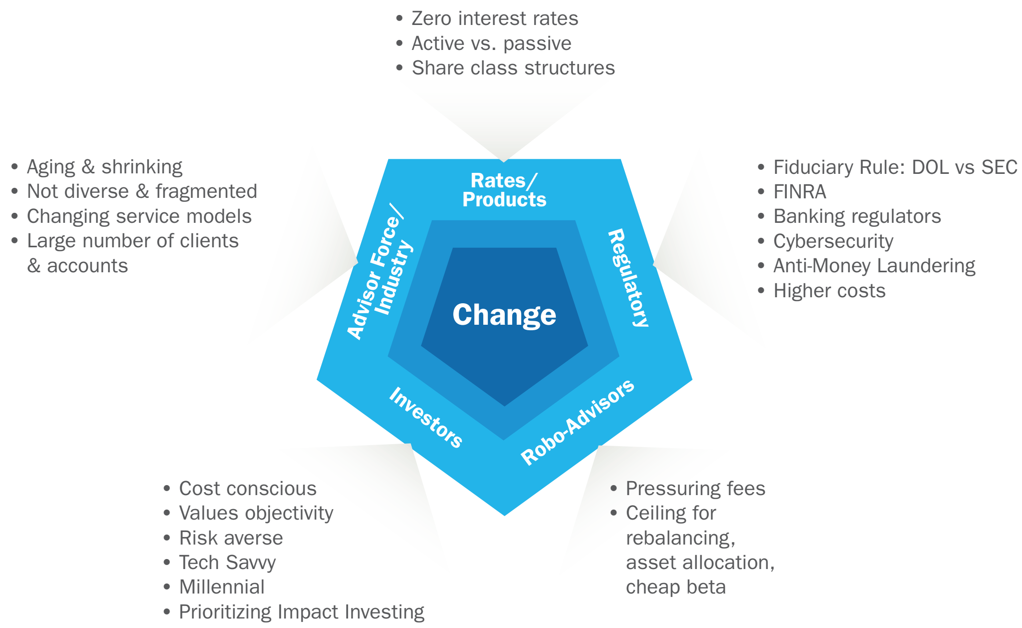
Not long after the 2016 election, the research group Aite noted the following in a research report, "The U.S. government taking office in January 2017 will determine the future of the DOL Fiduciary Rule. Yet what's passed to date is a significant education on the role of a fiduciary. Client conversations were held. Advisors trained. Announcements were made. Operational and compliance processes re-evaluated and redesigned. Could it all be undone and the sunk costs put aside? Yes. But would the industry and its clients want to? In a much-needed re-establishment of a trusted industry, it may behoove market participants to move toward a framework of safeguards for fiduciary actions and fee transparency."

In fact, DOL first pushed back the rule's applicability date by two months to June 9, 2017 at the behest of President Donald Trump, who signed an executive order in February 2017 directing DOL to review and potentially rescind it. The following extension of the transition period for the rule prolonged the already lengthy debate over what is going to happen next. Some think the delay implies these provisions will become applicable, while others consider it as a prolog of the administration's plan to permanently gut the rule.

Where does this leave the industry? Should the delay or the prospect of a revision of this regulation alter the industry's preparations and evolution towards a fiduciary standard of care for investors?

Despite regulatory uncertainty, there are massive market and consumer forces that are reshaping the way advice will be delivered in the near future. Beyond the ultimate fate of the Fiduciary Rule, the industry faces a crucial crossroad: pursue a business model that responds to the digital, demographic and economic pressures reshaping it, or breathe a sigh of relief and return to business as usual?

Market Forces



Alone, each of the market forces listed below would require thoughtful adaptation of the business model—combined they demand a transformation.

In this paper we will explore these industry dynamics and how successful advisors of the future will evolve their value proposition from making investment product recommendations to meeting the digital expectations of the consumer while also engaging clients in a more comprehensive conversation about the important goals and aspirations they have for their wealth—delivering a lifecycle of advice. This unique industry inflection point is what we see as the Fiduciary Opportunity.

The Lifecycle of Advice

The Lifecycle of Advice begins with a thorough understanding of a client's financial situation through data aggregation. Aggregated assets and liabilities then inform a goals-based financial plan that provides a roadmap to meeting a client's financial objectives. Based on the financial plan, the advisor recommends investment solutions in the best of interest of their client. The lifecycle of advice then continues with oversight and monitoring of the investment solutions in the context of frequent updates to a client's assets and liabilities as well as changes to their financial situation. Along each step and decision, clients are engaged according to personal preferences—with in person meetings, comprehensive reporting, digitally through an online portal or a combination of touch points and formats.

Adopting a fully-integrated technology platform with access to a network of investment management partners empowers advisors to deliver on this promise today by enabling them to:

Advisor of the Future: Four Pilars

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Improve understanding of the client— the combination of financial planning and data aggregation provides the holistic view of a client's household that will help advisors align investment solutions to be in their client's best interest.	**Accelerate client on-boarding and servicing**— using an integrated, end-to-end platform streamlines the onboarding process by increasing the accuracy of account opening and asset transfer instructions and reducing the transition time to the recommended solution.	**Enhance the advisor value proposition**— with increased competition and more informed investors, successful advisors will leverage a scalable framework to measure and communicate their value proposition.	**Turbocharge advisor productivity**— advisors utilizing advanced technology integration allocate significantly more time to client management compared to their peers with basic or no integration.

In this paper we'll look at each of these catalysts which, if implemented, will create the Fiduciary Opportunity for firms to transform their practices of today to become the advisors of the future.

Improve understanding of the client

The initial problem facing most advisors is that without advanced technology, they may not even have all the appropriate data and information they need to conduct a best interest assessment. Advisors using an integrated technology platform that includes data aggregation capabilities have access to all the crucial components needed to determine the client's risk tolerance, investment objectives, financial circumstances and retirement needs.

Leveraging data gathered through aggregation technology that remains current throughout the on-boarding process accelerates the transition process and improves accuracy.

Developing a financial plan is the foundation for the effective delivery of advisory services. The financial plan is a roadmap to achieving the client's goals—ranging from short-term income needs and extending to estate planning and philanthropy. Developing a financial plan centered on a holistic view of a client's complete financial picture is an area where data aggregation technology can offer a streamlined process that draws information from each of the client's accounts, including personal finance accounts, and inserts the data into reports and financial plans.

Accelerate client on-boarding and servicing

After gaining a complete understanding of a client's financial situation and designing a plan to meet their objectives, advisors should then recommend investment solutions in the client's best interest and execute an efficient transition. Leveraging data gathered through aggregation technology that remains current throughout the on-boarding process can accelerate the transition process and improves accuracy.

A key objective of the DOL Fiduciary Rule has been to increase fee transparency, since many retirement investors simply don't know what their investments cost. Utilizing up-to-date technology during the client onboarding process can help future-oriented advisors meet the Fiduciary Opportunity for account documentation and disclosures, particularly around fee structures. Advisors will need to demonstrate a best interest rationalization for any investment recommendations as well as an analysis of all associated expenses and ensure that the proper disclosures are delivered in accordance with the latest regulatory requirements.

Properly delivering, documenting and archiving client communications and disclosures will be a critical compliance responsibility of advisors. As clients' situations change and advisors respond with revisions to the financial plan and investment solutions, access to updated account information and integrations with client relationship management (CRM) systems will support efficiently servicing clients.

Enhancing the advisor value proposition

The successful advisors of the future will be those who can provide the greatest demonstrated value to their clients. The advisor's value proposition rests on five key components: financial planning; asset class selection and allocation; investment selection; systematic rebalancing; and tax management[1].

Advisors must be able to demonstrate that the portfolios they, or their outsourced providers, construct for clients are in compliance and free of conflicts. When an advisor evaluating their practice determines that financial planning is the most value they can provide to their clients, outsourcing investment management can not only create operational efficiencies but enable the advisor to spend more time with their client. The value of financial planning is mostly from its qualitative nature and the potential added value is difficult to quantify precisely for all sub-components of financial planning, but for asset location advice alone it can be about 50 basis points of value annually[1]. For advisors who provide

[1] "Capital Sigma: The Return on Advice", Envestnet, Inc.

investment management solutions, portfolio construction is also a key area where they can demonstrate their value to clients. A thoughtfully developed asset allocation that is both diversified and consistent with the client's risk profile and investment objectives can add 28 basis points of value annually[1].

Once the asset allocation is set and the product shelf analyzed, the advisor is tasked with constructing a portfolio reflecting the client's best interests. Research[1] has determined that employing a strategy of selecting active mutual fund managers according to certain risk-adjusted return characteristics can add 85 basis points of value annually to a diversified portfolio, and implementing the portfolio with passive investments can add 82 basis points of value each year.

Systematic portfolio rebalancing can help demonstrate proper oversight of the client account while also serving to both control risk by reducing portfolio volatility and enhance returns. The process of systematically rebalancing a diversified portfolio on an annual basis can add 44 basis points of value each year, compared to a naïve strategy of rebalancing once every three years[2].

Integrated technology applications can assist with compliance demands by automating calculation, reconciliation and allocation of fee payments and eliminating potential conflicts of interest by automatically leveling payments to advisors. Additionally, fully integrated technology solutions can simplify the tracking of third-party payments and establish procedures for detailed record-keeping and reporting, and aggregate transactional and account data from clearing firms and custodians much faster and more accurately.

Tax management is the fifth key area where advisors can demonstrate and add essential value. Advisors who use sophisticated portfolio tracking technology can follow a benchmark, and by taking advantage of tax-loss harvesting can add considerable after-tax value: potentially 100 basis points of annual value-add[2].

Turbocharge advisor productivity

Technology has, and will continue to, transform the wealth management profession by automating commoditized processes, thus allowing advisors to spend more time with clients, thinking strategically and creatively about how to help them achieve their goals.

One of the biggest stumbling blocks for firms wishing to position themselves for the future is failing to embrace technology that will turbocharge an advisory practice's productivity, demonstrate more value, and customize engagement with clients. Engagement with clients around an investor portal is no longer a differentiator but the cost of entry. Those firms which remain resistant to the benefits of integrated technology applications will be left in the dust.

Part of bridging the divide is identifying what today's clients want and need from their advisor. Firms that have been able to utilize technology platforms with fully integrated applications are empowered to engage with their clients in scalable way. Data aggregation and analytics are key drivers in this area, with research showing that advisors who use data aggregation and financial planning have twice the average share of wallet[3]. Advisors using an integrated platform that includes financial planning are able to complete, on average, 56% more financial plans than counterparts without integrated solutions[4]. By relying on integrated technology with data aggregation capabilities, advisors can focus their time and energy on what they do best—building client relationships and constructing portfolios to add value and deliver better outcomes.

Demonstrating the value of their advice and providing an outstanding client experience will be difficult to achieve without sufficient integration of technology solutions that increase the efficiency of financial advisors and their staffs. Firms that continue to use disparate pieces of legacy technology to perform operational processes increase the chance of human error when staff members have to toggle back and forth between applications as they manually key in data. It also takes more time to complete these processes than using fully integrated systems, which necessitates increased headcount as practices grow and operations staffs become overloaded (which can lead to even more errors).

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[1] "Capital Sigma: The Return on Advice", Envestnet, Inc.
[2] "Capital Sigma: The Return on Advice", Envestnet, Inc.
[3] Financial-Planning.com, May 2016
[4] "Technology Integration Turbocharges Advisor Productivity: Making Time for Clients", Aite Group

Properly delivering, documenting and archiving client communications and disclosures will be a critical compliance responsibility of advisors.

Advisory firms with an eye toward the future are turning to modern platforms that offer automated data sharing and functional integration across the business applications utilized throughout the practice. While modern application architectures allow for easier integration of business applications, putting together a fully integrated platform is outside the skillset of all but the most tech-savvy financial advisors. Pre-integrated platforms provide a much easier path to the ideal configuration.

Integration can also pay real dividends to the firms that take it seriously. Independent registered investment advisors (RIAs) and broker-dealers with advanced technology integrations are able to dedicate 11% more of their time to client investment management and generate around 50% more financial plans and investment proposals compared to practices that have basic or no integration[5]. This additional time spent on client-centric activities translates into the ability to serve a greater number of clients, create a larger book of business, and increase revenue for the firm.

With this in mind it is incumbent on wealth management firms and financial advisors to analyze their current technology toolkit against both their needs today and their projections for the near future. Staying wed to inefficient legacy infrastructure will squander precious time on tasks that fail to add demonstrated value for clients, and increase the possibility of failing to deliver on client expectations or meet regulatory requirements.

It has been shown that advanced technology integration allows more time to be allocated to client investment management—an increase of 19% for independent RIAs, 28% for independent broker-dealer practices, and 62% for bank/trust advisors, compared to peers with no integration[5]. In turn, the increased time devoted to client acquisition and investment management enables advisors to deepen the relationships with existing clients or increase their client and asset base. Advanced technology integration can also close up application gaps, with performance reporting, digital advice, and account aggregation being the most common.

Best Practices for the Fiduciary Opportunity

The first step toward becoming an advisor of the future is to ensure that your firm is ready to meet the Fiduciary Opportunity. The following outlines key areas of focus:

- Have record-keeping and compliance tools in place that ensure adherence with fiduciary standards;
- Write and distribute to clients a fiduciary acknowledgement letter;
- Evaluate and revise your digital communications and website content;
- Conduct advisor training to cover conflicts of interest, investment suitability, performance and fee data, et al;
- Initiate product shelf analysis; and
- Establish workflows to maintain and archive client transactions.

[5] "Technology Integration Turbocharges Advisor Productivity: Making Time for Clients", Aite Group

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Complying with the DOL Fiduciary Rule

Envestnet has been enhancing our platform to provide integrated technology solutions and consulting services that empower a fiduciary standard that responds to investor needs and elevates advisors' value propositions. As we have prepared for the DOL Fiduciary Rule, the following enhancements are available on the Envestnet platform:

A best interest assessment of each client—Advisors will have access to deliver an investment proposal with a financial plan. This will support an aggregated view of client data, understanding of client's financial situation and goals and a description of benefits and services for the recommended solution.

Analysis of suitability and the compensation arrangement for each investment product offered—Fee arrangements for current and proposed solutions can be compared, and available product lists can pre-set so only products with desired fee arrangements can be selected.

Client onboarding and service—Integration of aggregated data and financial plan into account opening and asset transfers will support accurate disclosure and documentation of recommended solutions.

Oversight and compliance—Ongoing surveillance reporting and automated analysis of accounts and transactions supports compliance with regulatory requirements and monitors for variances from the defined financial plan, risk tolerance and investment objectives.

Conclusion: Becoming the Advisor of the Future

Becoming the advisor of the future means always putting the client's goals first and helping them cut through the noise and confusion around investing. It means putting in the time to understand each client's personal circumstances, values, investing style, tax situation, and goals, and then developing and carefully monitoring a personal plan for each client, making timely portfolio adjustments to meet changing circumstances and needs.

Financial advisors must embrace what technology has to offer in order to satisfy the pressures for increased productivity and additional regulatory scrutiny. Clients today demand access to account information at any time, not just once a quarter. The ability to leverage a technology environment with fully integrated solutions allows advisors to reallocate time from operations and investment research tasks toward client prospecting and investment management. More time for client-facing tasks allows the advisor to either offer a much deeper level of service to existing clients, or to serve a greater number of clients.

Whatever the ultimate resolution of the questions surrounding the DOL Fiduciary Rule, the successful advisors of the future will likely offer their clients thoughtful, personalized advice, full transparency regarding fees and compensation and a wide range of conflict-free investment vehicles made possible through the use of thoroughly integrated technology.

To learn more about Envestnet's fiduciary solutions, visit envestnet.com/fiduciary.

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