Trend toward centralized investment advice will continue: Cerulli

By Editorial Staff *Thu, Sep 14, 2017*

Advisors at wirehouses and national broker-dealers will be do less investment management and focus more on client relationship-building and financial planning, explains Tom O'Shea, associate director at Cerulli.

To reduce dispersion of client returns and mitigate legal risks, more wirehouses and brokerages have begun encouraging their advisors to outsource portfolio construction and become relationship-builders, according to new research from Cerulli Associates, the global consulting firm.

“Going forward, if you want to be an advisor, you have to place your value-add on goal-based planning, and other higher-order planning activities. If your value prop is creating asset allocation models, then you have to rethink it,” Tom O’Shea, associate director at Cerulli, told *RIJ* in an interview.

The trend comes mainly from the Obama Labor Department’s fiduciary rule, which will have a big effect on brokerages regardless of how much the Trump administration weakens it, O’Shea said: “The people we talk to use a lot of metaphors like, ‘The horse is out of the barn’ and ‘the toothpaste is out of the tube.”

Wirehouses and brokers have seen the dispersion of returns created by independent-minded “reps-as-portfolio-managers” using discretionary managed accounts, and see legal or regulatory liability there. That risk exposure would largely vanish if a single, centralized investment team laid down investment guidelines.

More to the point, individual advisors too often deliver lower investment returns than the centralized team. “Many advisors pride themselves on their portfolio management skills,” said Cerulli, in a release. “But Cerulli finds that home-office portfolios outperform open portfolios managed by advisors.”

“As regulatory risk increases, firms look more closely at fees and pricing schedules, product choice, and advisor discretion. Home offices will require even the most sophisticated advisors to document each action to protect themselves from future inquiries,” the release said.

“Increasing due diligence may be cumbersome and expensive to many advisors. As a result, advisors will gravitate toward offloading this responsibility to their home office or a third-party strategist,” the release added.

“While advisors prefer managed account products such as rep-as-portfolio-manager (RPM) or rep-as-advisor, centrally researched, packaged offerings may be the future. Advisors enjoy the flexibility that RPM allows them, but more sponsors and advisors have started to realize that advisor discretion may not be optimal.”

Whether advisors would still be able to claim their own “book of business,” in terms of assets under personal management, or evolve into soft-skilled planners, or make as much money, O’Shea couldn’t say. But he agreed that advisors may not be compensated as much for delivering packaged products as for managing risky assets where they can attribute upside performance to their own skills.

Regarding a product like no-commission indexed annuities, first introduced in 2016, O'Shea doubted that advisors could justify charging a full one percent management fee on the assets devoted to those products, which are guaranteed and relatively static. He likened them to bond-ladders, on whose underlying value firms might charge only "25 to 30 basis points."

Of the managed account providers that Cerulli recently surveyed, 79% said they expected managed account fees to decline, with an expected reduction of about 10%, O'Shea told *RIJ*. "You'll see advisory fees coming down. The industry understands that."

The rise of computer-driven advice is also driving the trend. Digital advice appeared two decades ago with Financial Engines's algorithms and Monte Carlo simulations for individual retirement plan participants. The arrival of Envestnet and other turnkey asset management programs (TAMPs), which now manage about $250 billion, added momentum. In the last three years, with cheap computing and API plug-ins, robo-advisors have piled in.

"Digital advice is part of this trend, in the sense that it's a long term trend traceable to the beginning of online trading," O'Shea told *RIJ*. "Stockbrokering went away as a value ad. Digital advisors have already shown that creating asset allocation and rebalancing and security selection is analogous to what happened to stock trading in the 1990s. Its not a value add for the advisor. Financial Engines invented this in 1999, so its been going on for a long time."

Outsourcing of portfolio construction favors unified managed accounts (UMAs), which have grown 23.3% during the past year. Most advisors expect to increase UMA assets by 2018. At present, more than half (55%) of UMA assets are housed at wirehouses and 14.9% at direct firms, Cerulli said.

The third quarter 2017 issue of *The Cerulli Edge – U.S. Managed Accounts Edition* discusses in-sourcing versus outsourcing, and how age, designations, and channels are contributing factors, and how regulatory changes prompt review of packaged versus open or hybrid portfolios.