CONTROL VS. CUSTOMIZATION IN WEALTH MANAGEMENT

Advisor Discretion Doesn't Have to be a Zero-Sum Game

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Welcome

F2 Strategy and MyVest partnered to research the evolving state of discretionary advisory programs. While commonly referred to as "Rep-as-Portfolio Manager" or "Rep-as-PM" programs, the model is more widely adopted in our industry than simply by brokerage reps. So for the sake of this analysis we have coined the term "**Discretionary Portfolio Management (DPM)"** to define the advisory model used in different types of firms.

Through qualitative research, we set out to investigate the current state and future needs of DPM. We wanted to learn what firms are doing to better manage these programs and their advisors, including how they are responding to the tension between advisor customization vs. firm-level control of portfolios.

The primary audience for this research is strategic decision makers in the advisory business, including broker-dealers, banks, wirehouses, and service providers.

We hope that our readers will use this paper to learn how they can improve their DPM programs through the best use of technology and enhancements to their operating models, and what this means for their business decisions going forward. We look forward to hearing from you about your own experiences with DPM.

Doug Fritz
Founder & CEO

F2 STRATEGY

Anton Honikman
CEO

MYVEST

F2 STRATEGY

F2 Strategy provides boutique consulting services globally to support existing technology teams and marketing departments within the wealth management, family office, RIA and wealth manager space, to help these companies align their technology platforms and distribution channels with the wealth management experience that their clients expect.

MYVEST

MyVest builds enterprise wealth management technology for the digital age. Driven by a vision for client-centric advice, we empower firms to deliver personalized portfolios at scale.

A subsidiary of TIAA since 2016, we are headquartered in San Francisco with offices in Austin and Philadelphia.

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Executive Summary

While often overlooked for the more glamorous topics in our industry, **Discretionary Portfolio Management (DPM)** programs (and the tools that support them) are one of the most important business drivers, and often a source of underlying pain for advisory firms.

Advisor access to tools and the flexibility to create client-customized portfolios continues to be a significant driver of growth. It is often a lack of that flexibility that underlies headline-grabbing news about teams of advisors leaving well-known national firms. However, the increased pressure on customization comes with a commensurate need (and challenge) to control the risks they introduce.

The way advisory firms resolve the challenge of control varies widely across the industry. In our analysis, we cover several approaches to managing risk and controlling the level of customization. Each model has specific benefits and challenges, and it is most important that firms make deliberate decisions around what model works best for them. Many of the subsequent decisions, especially around technology, depend on knowing where a firm wants to draw the line between control and customization.

Technology increasingly facilitates controllable customization with proper risk assessment, portfolio construction, and rebalancing functions. When implemented correctly, these capabilities manage the expectations of clients and their advisors, plus the compliance oversight needs of the home office.

However, these technology capabilities are not universally adopted and their price tag is often out-of-reach for many smaller advisory organizations. In addition, ill-configured technology or improperly vetted vendors can create ongoing frustrations with advisors resulting in slower asset growth or advisor attrition. Selecting the right tool for each firm is complex and there is no silver bullet. However, the most successful technology implementations in this space match the right functionality with an organization's specific needs and strike a workable balance between advisor flexibility and tight risk controls.

The emergence of two compelling and competing models of delivering advice introduces a potential challenge for advisory leadership. Looking ahead, we find that the importance of enabling top advisors to deliver highly custom investment solutions will continue, and will likely fuel the battle for top talent. However, at the same time, a newer segment of advisors are increasingly eschewing the importance of customization and complexity in favor of a more goals-based/planning experience. There will be an emerging need for wealth COOs and CTOs to select the right tools that enable the best of both worlds – models that can extend flexibility when it is needed while reeling it back for clients and advisors when it is not.

Discretionary Portfolio Management (DPM) Defined

Broadly defined, these are **fee-based discretionary advisory programs where financial advisors act as money managers for their clients.**

The operating model and terminology for these programs varies among different channels (including regional broker-dealers, banks, wirehouses, and independent advisors):

- **In the standard Rep-as-Portfolio-Manager program**, the advisor takes full responsibility for selecting and implementing a client's investment portfolio.
- **For more centralized programs, like UMAs within banks**, the advisor may be responsible for relationship management while a centralized portfolio management team is responsible for the portfolio.
- **Then there are hybrids in between** where the advisor may be responsible for all or some aspects of investment strategy within firm guardrails while the portfolio management team implements the strategy.

Introduction

What technology trend in Wealth Management is most closely tied to firm growth and retaining advisors? Many industry observers and strategy firms would likely answer "digital" or '"frictionless process automation."

However, there may be a strong contender for any firm looking to grow assets and court (or keep) top advisors: **Discretionary Portfolio Management (DPM)** technology. F2 Strategy found that recent advancements and widespread adoption of DPM programs have created an undercurrent that few thought leaders are talking much about.

The following analysis is based on F2 Strategy's qualitative research, including interviews with nearly a dozen executives from wealth management and consulting firms, review of past analysis, and – perhaps most importantly – F2 Strategy's first-hand experience in reviewing these tools and deploying them to advisors.

The purpose of this research is to shed light on this trend, to define and sift through the nuances, drivers, frustrations, and best practices around DPM programs.

In our analysis, we wanted to understand the trends and perspectives currently driving the market, specifically:

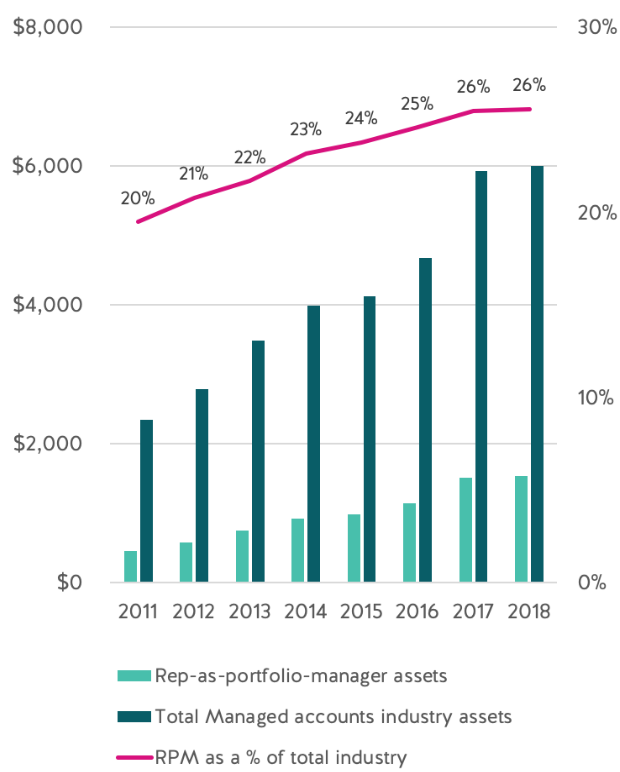
- What's driving the growth in DPM?
- How are firms and advisors managing the tension between control and customization?
- What technology is needed to run DPM successfully?
- What are some next steps wealth management executives can take?

What's Driving DPM Growth?

The expansion of this advisory model, and the technology that's enabling it, can be confusing and hard to pin down.

On the surface, the drivers of the DPM trend are in conflict. For example, Rep-as-PM specifically continues to grow in market share among managed account programs, from 20% to 26% in the past seven years. (See Figure 1).

Figure 1: Rep-as-Portfolio-Manager Assets Compared to Total Industry ($ billions)



Source: Cerulli Associates, "Cerulli Edge - U.S Managed Accounts Editions 2011 - 2019"

However, research shows that performance is higher with packaged, or modeled, portfolios offered by sponsor firms. (See Figure 2.)

Figure 2: Managed Account Performance by Portfolio Packaging

Managed Account Performance by Portfolio Packaging			
	Quarterly Return		
Quarter	Packaged	Hybrid	Open
1Q 2010	4.2%	3.1%	3.5%
2Q 2010	-6.6%	-7.8%	-6.0%
3Q 2010	8.4%	8.3%	7.2%
4Q 2010	5.3%	6.1%	4.2%
1Q 2011	3.0%	4.4%	3.2%
2Q 2011	0.5%	-0.3%	0.6%
3Q 2011	-10.6%	-12.8%	-9.5%
4Q 2011	5.4%	3.2%	4.5%
1Q 2012	6.9%	7.9%	6.1%
2Q 2012	-2.8%	-3.5%	-2.5%
3Q 2012	3.9%	4.1%	4.5%
4Q 2012	0.4%	0.6%	-0.1%
1Q 2013	4.4%	5.4%	4.7%
2Q 2013	-1.0%	-0.6%	-1.2%
3Q 2013	4.4%	4.8%	3.6%
4Q 2013	4.2%	4.8%	4.0%
1Q 2014	1.2%	1.6%	1.5%
2Q 2014	2.9%	3.3%	3.7%
3Q 2014	-1.8%	-1.9%	-2.1%
4Q 2014	1.2%	1.1%	0.9%
1Q 2015	1.8%	1.6%	-0.4%
2Q 2015	-0.1%	-0.5%	-1.0%
3Q 2015	-5.4%	-6.2%	-6.6%
4Q 2015	2.6%	0.6%	1.1%
1Q 2016	-0.1%	-0.6%	-0.2%
2Q 2016	1.5%	1.9%	1.4%
3Q 2016	2.8%	2.8%	1.7%
4Q 2016	1.3%	0.9%	0.7%
Growth of $100K Account	$142,466	$133,926	$128,943
Annual Return	5.19%	4.26%	3.70%

Analyst Note: Quarterly returns are calculated using the simple Dietz method for each company program that Cerulli tracks. Returns are net-of-fees.

Source: Cerulli Associates, "Cerulli Edge - U.S Managed Accounts Editions Q3 2017"

What would drive an advisor to pursue this model and the necessary credentials to secure this type of role within their firm? What would allow the sponsor firm to permit advisors to manage client assets in this way?

From our research, there are a few main drivers for advisors: **Discretion** over their own portfolios, which allows them to scale and take action as needed; and **Customization**, which puts them in a position to meet investor demand for truly personalized advice (and justify their fees).

Advisor Demand for DPM

Higher levels of discretion and customization are often credited with helping advisors grow their business by winning larger and more complex wealth management clients traditionally serviced by family offices or boutique RIAs.

In many of these complex wealth management clients, the normal guardrails set up by the home office can have a negative effect on the client's overall portfolio. Rigid model-based portfolios tend to constrain the advisor's ability to effectively meet the needs of the client, for example with handling complex tax, estate or position concentrations.

As a result – without the flexibility they need – advisors may see themselves as less competitive and, subsequently, growth-constrained. In other cases, we have advisors frustrated when their firm's rules force them to do the wrong thing for clients, such as forcing inappropriate allocations or trades.

One executive puts it simply: "Sometimes doing the right thing for the firm is clearly the wrong thing for our clients."

Furthermore, according to Cerulli, "advisors believe that this ability to determine asset allocations and select investment products is very important when justifying their fee. More than one quarter (28%) of all advisors indicate that the ability to validate their fees makes Rep-as-PM attractive." (From Cerulli Edge - U.S. Managed Accounts Edition Q1 2017.)

Because of this, the DPM offering has become a top selling point for attracting advisors onto sponsor platforms, as well as a bulwark against advisor attrition. In nearly all our conversations, executives were allocating resources and attention to expanding these DPM programs.

> **"It's the #1 focus when wooing advisors to join us: Come and be flexible with us.**
>
> We'll let you do what you need with clients and we'll give you the tools and infrastructure to be successful."
>
> - Executive of $100B DPM program

As one executive who oversees $100B+ AUM in DPM assets puts it: "It's the #1 focus when wooing advisors to join: 'Come and be flexible with us.' We'll let you do what you need with clients and we'll give you the tools and infrastructure to be successful."

An executive at a $70B AUM broker-dealer sees DPM as a major source of growth for the firm: "DPM is a selling point and growth is coming from outside. Half of all new recruited advisors have requested to be on the DPM platform. Most of these advisors are from wirehouses that already allowed some of the flexibility they were seeking. However, the platforms they came from weren't allowing them to scale and grow at the rate they wanted to."

Top advisors within large (and inflexible) wealth management firms have more options today to break away from their firm and grow their practice elsewhere. Barriers to setting up their own RIA have fallen with a number of firms like PFI Advisors or Dynasty Financial Partners, who are experienced and ready to support their transition.

In other cases, competing and accretive wealth firms will pay to bring on high-growth advisors and their assets. In most cases, these tend to be the top advisors at their firm and represent a significant flight risk to firms that fail to offer incentives to stay. DPM has become a powerful carrot to retain top advisors.

As Alois Pirker, Wealth Management Research Director at Aite Group, puts it: "[Advisor flexibility and autonomy] will continue to drive the RIA marketplace and [sponsor] firms to come up with other ways to retain top advisors. It's something that's going to continue to drive competition and increase the drive toward allowing more advisor customization and discretion within firms."

Growth Comes at a Cost

However, increased advisor discretion may come at a cost for firms. For many, it is (at best) a "tolerable byproduct" of being competitive and, for many executives we spoke with, something that keeps them up at night.

Where model-based portfolios are centrally-managed and carefully tended to, DPM portfolios are generally left to the whims and management process of their advisor. This can mean serious risks like company concentrations, portfolio drift, performance inconsistencies, and compliance issues can get out of control without anyone knowing about it until it's too late.

In every conversation F2 Strategy had with executives about their DPM platform, the risk of unknown behaviors and lack of control around what/when/how client portfolios were being managed created the most anxiety.

> "[Advisors] with more discretion are most successful in courting clients away.
>
> **At best we manage to retain only 50% of assets after they depart."**
>
> - Wealth management executive

Without the right tools to ensure a proper mix of customization and control/oversight, these risks have led to the clamping down of advisor control and flexibility in some firms.

Interestingly, one executive puts some additional caution behind the push toward more advisor autonomy and flexibility:

"We've noticed that when [advisors] leave, the ones that had more discretion are most successful in courting clients away. At best, we manage to retain only 50% of assets after they depart."

Balancing the Needs of the Home Office and Advisors

Advisor flexibility requires a comprehensive and often costly overhead for home office compliance, risk management, and technology staff.

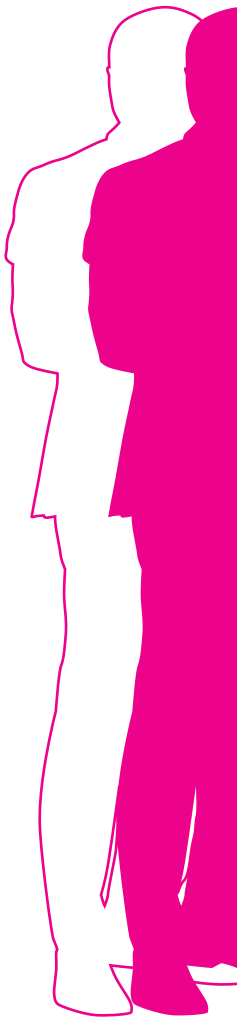
Without enough oversight from a home office, including institutional quality analysis, quantitative algorithms and comprehensive research, advisors are at risk of making disastrous mistakes which can cost their clients dearly. If bad enough, these issues can be a drain on the firm's reputation and ability to win new advisors and clients.

"It's a big retention issue," says Dennis Gallant with Aite Group. "Firms must retain advisors that want the flexibility, but still control those that won't be able to deliver the performance."

He continues, "Misused DPM capabilities are also a retention issue, as advisors are seeing the reputational risk of their peers blowing up portfolios (publicly) and draining their own credibility."

While this risk is something that came up repeatedly, the perception of risk may be based on experiences and stories from the distant past:

"As an industry, many of the bad apples were weeded out over the last 10 years," says an executive from a national wirehouse. "By and large, the quality and credentials of our current advisors are light years ahead of where it used to be, which allows us to be more flexible and accommodating for increasing advisor capability."



Control vs. Customization

Central to the tension and trade-offs experienced by firms designing more competitive DPM platforms is: "Where do we draw the line?" The level of customization that advisors have must be balanced with firm oversight or tracking. The failure to get this mix right is potentially disastrous to any firm.

How Firms Do It: Balancing the Demand for Customization with the Need for Control

In order to deliver the most competitive investment platform to discretionary advisors, home offices need to enable just enough flexibility to win (or keep) top advisor teams while still protecting clients and the firm by ensuring compliance rules are appropriately set and followed.

That's no small task and our interviews uncovered a few common approaches:

Limited Flexibility within Firm Guardrails

We found this approach to be the most common, and includes established client investment objectives, firm-defined allocation ranges, and a set of firm-approved assets/strategies to select from. In most cases, these programs were well-honed from a long history with the DPM approach and had higher levels of automation for monitoring, rebalancing, trading, alerts and varying levels of integration.

Flexibility from a Set Menu of Options

Another approach ensured that the assets in client portfolios were from a well vetted firm-approved list, but advisors had more discretion as to how and when those assets were deployed.

Firm-level oversight of Investment Policy Statement (IPS) compliance or drift reporting were available, but not universally enforced. This model was more common at larger regional bank-based wealth firms.

Decentralized with Light Oversight

Some firms pushed advisors to qualify for the program with such high standards that the required oversight/control function was deemed to be little more than weekly compliance reporting.

These firms appeared to rely on the advisor's CFA standard and technology training to stay on the rails. Noticeably, these were smaller firms that were growing their DPM business.

> "**It's a big retention issue.** Firms must retain advisors who want the flexibility, but still control those who won't be able to deliver the performance."
>
> - Dennis Gallant, Aite Group

Decentralized Overlay

After observing these approaches, a compelling alternative is what we'll call "Decentralized Overlay" that combines the best of advisor discretion and firm control.

In this approach an advisor acts like an overlay manager on their own book of business, where they bring their own allocations, models (potentially co-existing with firm-provided models), and client personalizations into an automated overlay management system.

For the firm, this allows for ongoing IPS compliance and a repeatable process.

For the advisor, this still allows for customization and influence over the investment solution, while benefiting from the scalablity of managing by exception.

Accreditation

Regardless of which model, all firms we interviewed used an accreditation process to control who had access to the really sharp tools. As a Money Management Institute report observed:

"Advisors must meet a number of criteria before being approved by their firms to conduct DPM business. There is typically a minimum educational level for advisors, such as receiving the CFA designation or passing an internal training program.

"Advisors are also required to have a certain number of years of investment experience, meet requisite asset and production hurdles and follow any firm-related portfolio construction rules. They must also, of course, have and maintain an acceptable compliance record in order to be approved for a firm's DPM platform." (MMI Central 1Q 2017, "An Insider's View: Rep as PM Platforms.")

Many of our respondents went further. One west coast regional bank executive adds "advisor thesis and methodology need to be regimented, predictable and testable. This is what keeps me up at night the most."

Configuration Choices from Centralized to Decentralized

Figure 3 demonstrates how firms can configure the roles and functions of their DPM platforms along a spectrum of discretion to achieve different levels of centralized vs. decentralized portfolio management.

Figure 3: The Spectrum of Discretion

Firm   Advisor

	Fully Centralized	Limited Flexibility within Firm Guardrails	Flexibility from a Set Menu of Options	Decentralized Overlay	Decentralized with Light Oversight
Allocation Ranges	Firm	Firm	Firm	Firm / Advisor	Advisor
Assets / Fund Selection	Firm	Firm	Firm / Advisor	Firm / Advisor	Advisor
Rebalancing / Trading	Firm	Firm / Advisor	Firm / Advisor	Advisor	Advisor
Compliance Oversight	Firm	Firm	Firm	Firm	Firm
Accreditation Standards	Low	Low / Medium	Medium / High	High	High

More Firm Control ⟷ Less Firm Control

Solutions: The Technology Needed To Be Successful

Undoubtedly, the single largest contributor to the growth of DPM has been the improvement in technology to oversee, manage and report on DPM programs. Without tools to manage them, the risks associated with discretionary advice would be substantial.

The advent of modern portfolio management and rebalancing software has made mass customization and risk control not only practical but advisor-friendly and increasingly comprehensive.

So specifically, what types of technology capabilities do firms need to have in order to run their own DPM platform?

Client Profile & Risk Tolerance

Advisors need to be able to process some level of client preferences and risk tolerance to tailor each portfolio.

In its most basic form, this is done with a simple questionnaire and basic demographic information. Most include client age and expected years-to-requested distribution, as well as some measure of feelings towards risk associated to portfolio fluctuation short & long-term, near-term liquidity needs, and appetite for risk in general.

In more comprehensive models, advisors may employ behavioral finance tactics to uncover the drivers and nuances of a client's risk tolerance. Account aggregation technology can also be employed to gather a holistic view of the client assets and risk capacity to drive a goals-based strategy.

The results of both approaches are similar: a framework to capture a personalized set of criteria including risk tolerance & capacity, and guardrails in an IPS to automate implementation and oversight.

Platform of Models, Managers/ Funds or Securities

Advisors in DPM programs need to have a set of approved models & securities to deploy into client portfolios. These can vary from:

1. Packaged models consisting of individual equity, fixed income, mutual funds, or ETFs
2. Individual SMAs
3. UMAs, which can be a combination of #1 and #2

All of these models can be implemented by several players. The home office or third party managers can control one or more sleeves. The advisor can also control their own sleeves, while using these firm-approved building blocks for the rest, which allows for total flexibility.

> DPM is a selling point, and growth is coming from outside. **Half of all new recruited advisors have requested to be on the DPM platform.**
>
> The platforms they came from weren't allowing them to scale and grow at the rate them wanted to.
>
> - Executive of $70B broker-dealer

The advisor can also control the strategic allocation and choose when to rebalance, even though the home office may control the underlying model constituents.

Monitoring, Trading and Rebalancing

In most cases, the DPM programs can put portfolios into an auto-pilot process to help advisors work by exception and scale their practice, where monitoring, alerts, and trades are automated. These tools differ widely in their ability and value to both advisor and client. The most primitive tools can monitor daily for portfolio drift (the inevitable difference in growth between major asset classes and holdings that need to be re-established periodically to maintain the right targets).

More comprehensive tools will automate the trading of portfolios once they approach certain criteria (e.g., portfolio was overweight in Mid-Cap Value for greater than five consecutive days).

Even more comprehensive tools will allow for some level of tax-loss harvesting to occur during rebalancing. These systems can propose (and execute) trades to rebalance the portfolio in a way that minimizes a client's tax bill.

To better manage advisors with more discretion, oversight can include monitoring for use of approved securities, violation of firm-wide program rules, and conformity with IPS guidelines.

In recent years, newer technology has been introduced that allows advisors to set up truly comprehensive portfolio scenarios, by deploying the universe of investments across multiple or all of the accounts in a household through a Unified Managed Household (UMH).

This framework can help advisors change their point of view from the account to the household by managing multi-account, multi-custodian portfolios (including interpreting the impact of held away assets), employ tax management at the household level (including wash sale monitoring and asset location across accounts), and automate implementation around the IPS guidelines to truly customize the solution for the client.

These tools are highly complex and efficient at automating sophisticated portfolios, and are the current gold standard for portfolio management technology.

What to Look for in Your DPM Technology Solution

For those ready to invest in their platform, what should you look for in your ideal technology solution?

1. **Configurable:** A configurable portfolio management system that simultaneously supports multiple advisor types with varying degrees of discretion.

2. **Holistic:** The ability to broaden the focus beyond the individual account to consider investment solutions across multiple registrations in the household. Adding an accommodation for held-away assets will enable the ultimate in portfolio customization.

3. **Adaptable:** A platform that will evolve as your business changes and grows. This requires a data-driven, scalable architecture, ongoing investment in modern technology components, comprehensive APIs to support multiple points of integration, and configurable workflows.

Common Frustrations with DPM Technology

It's all too easy to overlook the complexity and nuances associated with selecting, configuring and deploying tools to discretionary advisors. In the decades we've been working with advisors, the F2 Strategy team have some appalling (and often funny) stories behind the projects, tools and personalities of wealth technology.

In many cases, just a few smart questions up front could have saved millions of dollars (and years of time). The net results are that few advisors are truly pleased with the way their current toolkits are configured.

Out of Reach for Many Advisory Firms

One of the most frequent complaints we hear from advisors is the lack of portfolio management automation. From our research, only about 1 in 3 wealth firms have deployed the types of portfolio automation tools needed to scale and simplify their businesses. Many compensate with copious Excel spreadsheets and a blind eye. However, even among the DPM advisors with modern toolkits, there are some frustrations.

Most Common Advisor Issue: Account (Not Relationship) Level Management

The most common frustration advisors have with their tools is an inability to manage across multiple accounts and account types. Many portfolio management tools were built to handle a single account type at a time (e.g. tax deferred or exempt IRAs) and force users to manage two or more portfolio models for a single client.

One of our wirehouse executives noted significant frustrations from advisors implementing SMA portfolios. Multiple models and the necessary compliance paper trail makes it difficult for them to compete on complexity while also scaling their practices.

This dissatisfaction is starting to boil over, and we've seen several large team departures due to the issues around technology and its negative spillover to client experience.

Most Common Firm Issue: Limited Configuration Inhibits Oversight

Another common issue we heard from our participants was a lack of configurable control over the actions and outcomes within DPM portfolios. Many of the tools only allowed a single configuration for all users, regardless of client or advisor need. The inability to set rules and functions for specific use cases meant that compliance and regional leadership were chasing down issues and reviewing monthly audit reports.

In many cases, just a few smart questions up front could have saved millions of dollars (and years of time).

The net results are that few advisors are truly pleased with the way their current toolkits are configured.

In other cases, the technology did not enable different product sets or portfolio construction flexibility needed across multiple product lines. That led to many firms having two (or more) portfolio management tools across their footprint.

The sum of these frustrations is lack of automation and scale, which ends up costing the firm in time as well as excessive vendor expense.

Frustrations with Vendors

Some of our respondents were pleased to see their vendors delivering on innovation and improving their advisor experience with new functionality and more streamlined processes. Combined with newer tools in the market, today's tech decision makers have far better options than they did in the past.

However, not all DPM vendors are spending their time and resources on innovation, and more than one wealth executive voiced frustration at their software provider stating: "We'd like to give our advisors more flexibility, but our current tool is overly rigid. We don't have the budget to pursue a new provider, and unfortunately we're left beating up on the vendor to make the changes they've promised for years."

We heard this frustration from many participants who felt that their DPM vendors were too focused on acquiring competitors and courting new clients, and had poor records of following through on promises to add better risk oversight functions and increased advisor flexibility.

ROI on the Technology Spend

Lastly, cost can also be a frustration (and possibly a limitation) to more firms deploying advisor automation. The cost of DPM tools varies widely, and the breadth and depth of functions you get from different technologies is pretty shocking. In general, vendors are either broad (offering many different capabilities and widgets) or they are deep (enabling higher levels of complexity and customization).

In our experience, few wealth firms take the time to do sufficient due diligence to make great decisions, and there can be a big difference between expected and realized ROI.

Smart wealth technology purchasers know enough about their own organization and business needs to pick the right toolsets to retain advisors, meet client needs, and reduce risk.

Key Success Factors for Implementing DPM

1. **Identify external partners you can work with to begin forging your path to the future.** There are many in the industry who strive to accomplish the same as you, and they can support you from planning through implementation.

2. **Make a business case, starting with the pain of your most valuable advisor teams.** The revenue you risk losing if they depart your firm can inform the level of investment in improving the customization and oversight of their portfolios.

3. **Avoid the big bang of completely replatforming all at once.** Orchestrate a transitional period that demonstrates the power of the new while maintaining the old, setting the foundation to move legacy programs onto a new modern architecture.

4. **Foster internal champions who will be ambassadors for the initiative.** They can encourage adoption and develop internal SME support, to help you move to a more profitable business model over time.

Conclusions & Looking Ahead

Discretionary Portfolio Management is not going away, and neither are its inherent conflicts. So, what are the key considerations for firms looking to deploy or upgrade their DPM platforms?

DPM Tools Are a Mix of Compliance and Competitive Capabilities

First off, despite the focus and marketing spin around it, promoting DPM programs isn't really all about compliance. None of the sponsor firms we spoke with viewed risk management and the controls around advisor behavior as the main reason behind their decisions. In fact, it's all about winning the hearts of advisors.

This appears to be such a strong trend that some of the bank-based wealth executives we interviewed were moving to expand their DPM platforms, despite very clear evidence that more advisor customization delivered lower-performing client portfolios (see Figure 2).

As one executive said, "Regardless of the obvious pitfalls, costs, and questionable client value, we see the need to take this step to attract new teams."

The Challenge of Managing Multiple Advice Models

While today's top advisors are looking for highly flexible DPM tools to help accelerate their practices' growth, several wealth executives noted that their most successful and younger advisors are not as interested in selling the machinery of investment management, customization or out-performance.

They sell service, trust, and access to a team of smart financial coaches.

Furthermore, Dennis Gallant with Aite Group says, “Firms wouldn’t be doubling down on their in-house model platforms if they didn’t see a trend where the advisors were more apt to outsource or delegate part of their investment management.”

During this transitional phase, there may become a stark dividing line between these two advisor personas. Managing and facilitating these separate advice models is a challenge many firms will have to prepare for.

> Think of DPM as an enterprise framework to deliver the **customization investors demand** with the **oversight firms need** to protect both themselves and the client.

The Right Technology Will Make or Break Any DPM Program

The most successful advisors will find a sweet spot between scale and client service to win more complex and high net worth business. Without the right DPM tools, their sponsor firms are going to be challenged to enable sufficient flexibility while keeping risk in check.

The unfortunate truth, however, is that many firms may try to avoid making tough technology decisions and will either bleed advisors, or worse, incur unmanageable risks.

More Than Features - A Framework

DPM tools should not be thought of simply in terms of features and functionality. Think of DPM as an enterprise framework to deliver the customization investors demand with the oversight that firms need to protect both themselves and the client.

Firms can use the framework demonstrated in the matrix in Figure 3 to map out their current and future state to strike the right balance between control and customization.

In the long-term, the boundaries between advisor-driven and centrally-managed programs will blur, and all programs will exist on a spectrum with varying levels of configurable advisor discretion.

DPM and its variants will occupy an important place on that spectrum, always accompanied by some degree of centralized oversight.

How that balance is struck will depend on the firm’s strategy, driven in large part by the importance of centralized standards versus the importance of advisor retention. Choosing the supportive, configurable technology will play a critical role in achieving this balance.

F2 STRATEGY

f2strategy.com
hello@f2strategy.com
415.844.0641

MYVEST

myvest.com
info@myvest.com
415.369.9511