What will the DC advisory practice of 2019 look like?

THE PRACTICE OF THE FUTURE

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G

ame on! DC plan advisors, who have toiled away in relative anonymity within their broker dealers and retail investment managers, now find themselves squarely in the spotlight.

With more and more aggregators forming and growing, these groups are starting to get a whole lot of attention. The phenomenal growth of NAPA, which has rocketed to nearly 10,000 members in just over three years, highlights the growing attention that state and federal lawmakers have placed on plan advisors and the concern among these professionals that they need a concerted and thoughtful voice to counter the attacks.

Amid all this change, we set out to try to do what seems to be very difficult in the financial services industry — to envision the future and try to predict what DC advisory practices will look like in three to five years.

As you might expect, we found varying opinions among leading advisors and industry experts about the future of plan advisors. But one belief that rang loud and clear for everyone was that change is afoot and advisors have to keep evolving. As Winston Churchill said, “To improve is to change; to be perfect is to change often.”

As plan advisors — and especially aggregators and large practices — grow, they are taking center stage at the expense of record keepers. They are becoming the hub, no longer just a spoke, in the wheel that will propel retirement in the future. As Babu Sivadasan, president of Envestnet Retirement Services, asked rhetorically, “Why would a record keeper create an open architecture which is less profitable?” And Dick Darian of BlackRock’s DCIO group noted that, “Those closest to the customer are the ones with the power.”

Common Ground

Before we get into where the experts diverged and take a look at what the DC advisory practice of the future might look like, let’s take stock of at seven things almost everyone agrees on.

Growth of Teams and Aggregators

Just as record keepers went through massive consolidation a decade ago (a trend that continues to this day), advisors will need to go big or go small. Advisors that remain in the middle will surely be squeezed by better capitalized and more efficient larger competitors, as well as nimble smaller ones who can maintain margins in a deflationary market.

‘F’ Stands for Failure

Advisors focused on “fees, funds and fiduciary” will be outflanked by ones that bring differentiated value in the form of better outcomes for both participants and companies. Meanwhile, almost every advisor servicing plans above a start-up will have to be a fiduciary, with many headed toward the pure RIA model.

Smarter Plan Sponsors

Clients will demand more transparency, which should cause continued price deflation — but not for those that show value. Everyone is expecting the RFP process, common for record keepers and money managers and promulgated by advisors over the past decade, to migrate to advisor RFPs and due diligence.

Technology & Marketing

The successful practices of the future will incorporate more technology and have a focused marketing strategy executed by dedicated professionals. That takes capital and scale — which leads back to the growth of teams and aggregators.

Data Rules

As it is with gold, he who owns the data rules. Record keepers may be reluctant to share it with advisors, but that ship has sailed. It’s not about “if” anymore, it’s about when and how.

Cross-selling

Relationships are expensive to develop, so advisors have to either cross-sell corporate services or work with participants on outside assets and rollovers — or both.

Outsourced Fiduciary

Starting with 3(21), migrating to 3(38) and ending at 3(16), there will be more demand for outsourced fiduciary services by plan fiduciaries.

Practice Management

A decade ago, record keepers started on a massive consolidation track, which
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continues today. It’s tempting to use that as an analogy for plan advisors, but there are some fundamental differences. Though pricing pressure has affected both sectors, record keepers are more reliant on technology and therefore are more scalable than advisors, who are basically consultants — an endeavor in which leverage is still important but not as scalable.

“Advisors show up at the office each morning and have so much to do,” observed CAPTRUST’s Rick Shoff, a former advisor himself. “They have to determine the highest and best use of their time — which usually means doing what they do best.” Only in a team environment, says Shoff, “can they go deeper, with fewer relationships where they have a competitive edge. For many advisors, 20% of their clients generate 80% of their profit.” And when their practices grow, it’s harder to sustain a steady growth rate, which can only be accomplished by marketing constantly, refusing to be burdened by low-value administrative duties.

The fundamental question that an advisor needs to answer, according to 401(k) Advisors’ Paul Powell, is: “Am I a sales person or a businessman?” Mark Chamberlain, Tim Rice and Tim VerShure, Lakeside Wealth Management’s brain trust, note that, “It’s becoming increasingly harder to be a CEO and practitioner.” Rarely do the two responsibilities coexist comfortably in one person. And even when they do, the advisor still needs to decide where to focus.

Pensionmark’s Troy Hammond, who saw his firm grow from 26 offices in 2013 to 40 in 2014, sees consolidation accelerating at a faster pace. In part, Hammond says, this is because, “There’s a growing demand and awareness that advisors need to focus on more revenue-generating activity, such as client-facing and prospecting rather than process.” That is especially important because advisors have to service more plans to maintain profitability as prices drop across the board.

Vince Morris at Bukaty voiced another key theme: that bigger groups provide shared services, from technology to marketing to HR. “Even if an advisor can afford to hire a marketing person, for example, the better marketing people will be attracted to bigger organizations that have more resources.”

Cross-selling

Though it seems like cross-selling corporate and individual clients is common, that wave is just building and will only continue to build momentum. Cross-selling and consolidation can be viewed as two sides of the same coin.

Some consolidators, like SageView and, to a certain extent, CAPTRUST, tend to try to be more focused at vertical rather than horizontal growth, adding offices nationally rather than trying to sell more services to the same client.

But others like Bukaty are trying to leverage their “Four Corners” practice covering health care, retirement, wealth management and P&C. Jim Sampson, a New England-based advisor, observes that, “You can’t just do retirement. There’s a demand from clients to provide payroll and HR, something that payroll companies realize early on. There’s a reason that McDonalds sells more chicken than KFC — distribution and access to the customer.” His firm, which includes a TPA and a health care practice, intentionally does not cross-sell wealth management services or try to capture downstream revenue. Sampson believes this is an advantage because he is not harassing employees.

But Hugh O’Toole has a different and unique view. O’Toole led sales at MassMutual and recently left to pursue his entrepreneurial dream. Rather than providing benefits, O’Toole sees companies allocating a set amount of money to employees each year and giving them the opportunity to select the benefits that make the most sense for them from an exchange that the company sets up and the advisor manages. The “Four Corners” exchange could include health care, retirement, life insurance or protection and executive deferred comp. It might not make sense for low-income employees, who are barely making ends meet, to contribute to a DC plan. On the other hand, DC plans will barely make a difference for high earners, who should put most of their discretionary dollars into a non-qualified plan. In this scenario, the advisor uses payroll and medical data, which is richer, to determine which benefits makes sense for each person.

O’Toole notes that, “Benefits should be applied by socio-economic profiles. Employers are not in the business of supplying benefits. It’s the cost of doing business and they will want to outsource as much as possible. However, the cost of people making a mistake is that they have to work longer — which increases costs in the form of older workers who have higher contingent liability.”

Technology and Big Data

No, technology will not solve the retirement crisis, just as it cannot put out fires or stop crime. But advisors that leverage technology will be better positioned to improve outcomes by reaching more participants — as well as run their practices more efficiently. There’s a lot of publicity and speculation about robo-advisors and whether they pose a threat to traditional advisors. As financial advisor and blogger Michael Kitces aptly observed, “If all an advisor does is what a robo-advisor does, then that advisor is in trouble. Providing value on top just makes the advisor more efficient.”

“Technology will allow advisors to create more customized communications,” notes Orlando-based advisor Jason Chep- enik, “which includes personal enrollment videos that leverages data already available as well as texting people to remind them to take action or warn them about opting out.”

Pensionmark’s Hammond, who was trained as a technologist, sees everything being run off of a CRM system, including
investment reports. Sheridan Road’s Jim O’Shaunessy looks to his BD or RIA to provide the base technology augmented by custom reports, especially investment monitoring for larger plans. “Getting data is the biggest problem because there is no centralized platform capturing plan and participant data. We are meeting with record keepers to get the same data feed,” he says.

O’Shaunessy sees technology delivered by a sophisticated back office as a way to provide smaller plans with services similar to those that large plans enjoy, as well as outsourced fiduciary services — simplifying deliverables like the investment menu. O’Shaunessy notes that, “We’re looking to consolidate the number of record keepers we work with, focusing on the five or six survivors who can span multiple markets. Right now we have 20 to 30 partners, which does not make sense.” BlackRock’s Darian envisions “custom built, unitized managed investments with five different models for people the same age. That means we have to go beyond record keeper data.”

Envestnet is trying to be that data hub for advisors and to provide the tools and services that would allow them to build custom portfolios. As a bridge to advisors and broker dealers, that option may be preferable for record keepers, who want to feed data to one source. Technology will unleash the power of customization, making the system more about the needs of the participant rather than being a slave to the systems, which Envestnet’s Sivadasan claims is “silod among the various providers who touch the data, like record keepers and custodians. Investors would be better served by customized investments than by target date funds — which will also allow advisors to show more value.”

Some record keepers don’t want to share the data because they want to capture the downstream revenue. A major small-market provider was at the one yard line with the industry’s top wire house but walked away because they would not hook into the BD’s rollover capture system. And others are not willing to join LPL’s Worksite Financial program because they want to capture downstream participant revenue themselves.

LPL’s Adam Sokolic agrees that technology and data are the keys to Worksite Financial. The program allows advisors to work more closely with participants from cradle to grave, providing a “simple instant sign-on branded by the advisor. Technology which will go more mobile can give advisors the business intelligence they need to run their business and better serve clients.” Because of LPL’s size and reach, Sokolic wonders whether smaller firms can catch up. And while he admires the ambitious nature of Envestnet’s undertaking, he questions whether they can actually accomplish their goals.

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Affecting Outcomes
The race is on to improve participant outcomes. But before advisors and providers get too carried away, let’s be realistic. Before plan sponsors will even begin to focus on outcomes, they need to limit liability, costs and work. Even then, some companies who do not see their DC plan as a differentiator or understand the costs of people working longer will not value improved outcomes. DC plans have basically given plan sponsors a free ride if they have followed the rules and checked the boxes. As Jamie Hayes of Fiduciary First in Orlando notes, “The rules need to catch up with best practices, not penalize them. There should be new types of safe harbor rules for plan sponsors who try to optimize plan outcomes — not penalties.”

Advisors need a way to measure outcomes, or “DC Alpha,” in the form of income replacement ratios in order to show the value of all their increased efforts. Auto plan design features now being employed by many plans have gone a long way toward moving the needle, so advisors have to figure out a way to add value on top of these features.

Hayes, who works closely with UCLA’s DC befi guru Shlomo Benartzi, incorporates befi into her plans. But Hayes also uses CFPs employed by her firm who “Meet one-on-one with employees to create a holistic financial plan compared to a simple asset allocation for their DC plan.”

Bill Chetney, who recently left his corporate position at LPL to form Global Retirement Partners, an OSJ under LPL and an independent RIA, believes that partnering ERISA experts with armies of retail advisors will build that last mile to the participant. “No one would have believed 20 years ago that advisors could have sold 1 million DC plans, but they did. Now no one believes that advisors can meet one-on-one with 80 million participants, but they can.” Noting that, “retail advisors are a dirty word in our industry,” Chetney plans to match retail advisors with plan advisors, “to fill the void between people who need help and a trained network of retail advisors.” Unfortunately, there’s no training system as there was in the old insurance model that Chetney grew up in.

Conclusion
So what does the future hold? What will retirement plan practices look like in three to five years?

The big focus will be on three key elements:
- Improving outcomes.
- Growing teams that can service all benefits to employers while working with participants to capture downstream revenue.
- Using technology to manage big data, enabling advisors to be more efficient and to customize benefits and investments.

Advisors that do not or cannot be business managers will either join a team or stay small, leveraging outsourced data aggregators who will provide a dashboard enabling them to see and manage all plans and participants on mobile devices and to make changes instantly.

And there will be more advisors and fewer providers, with many making an “Irish exit” if they cannot service plans of all sizes. [8]