The Case for Outsourced Investment Services for Financial Advisory Firms

MEEDER

The Case for Outsourced Investment Services for Financial Advisory Firms:

A New Approach for Broker-Dealers and RIA Firms

Today's disruptive events, financial market swings, and shifting demographics are putting increasing pressure on financial advisors to meet client demands. To adapt to these changing dynamics, financial service firms need greater efficiency and scalability to successfully manage unique client needs, develop business opportunities, and elevate their practices to the next level.

Industry-leading broker-dealers and RIAs are increasingly partnering with third-party investment management firms to enhance their core capabilities.

KEY BENEFITS

01 Expand their approach using a multi-disciplinary process to guide the delivery of customized portfolios and specialized client-aligned solutions

02 Create a more competitive client experience through knowledge sharing and unique portfolio personalization

03 Grow efficiencies and advisor capacity through partnering for investment management and administration

WHAT ARE OUTSOURCED INVESTMENT SERVICES?

Outsourcing non-core investment services can bring the impact of having a Chief Investment Officer (CIO), ultimately responsible for the firm's investment strategies, at each advisor's command. Some of these tasks include the ability to analyze, construct, select, implement, optimize, monitor, and mitigate risk in investment models and portfolios. Due to the magnitude of this responsibility, a CIO commonly manages the talents of a team of highly skilled investment professionals to accomplish this.

Over time, the needs of investors have augmented to be more individualized. Therefore, the requirements of investment professionals to conduct the necessary research and due diligence of these investments are becoming more complex and time-consuming. This is requiring many firms to increase the number of dedicated resources needed to fulfill these obligations. This led the industry to the increasingly popular trend of outsourcing these duties.

External investment advisory partners will generally offer a menu of firm-specific customized services which can be selected to fit the needs of each firm's advisors. Since its inception, the outsourced investment services model is becoming more widely adopted. According to Pensions & Investments, AUM totals managed by OCIOs around the globe rose to $2.46 trillion as in 2021.

GROWTH OF INSTITUTIONAL OUTSOURCING

ASSETS ARE IN BILLIONS AS OF MARCH 31, 2021.

SOURCE: PENSIONS & INVESTMENTS

WHAT TRENDS ARE DRIVING ADOPTION OF OUTSOURCING A CHIEF INVESTMENT OFFICER MODEL (OCIO)?

Outsourcing the role of a Chief Investment Officer became more popular after the Financial Crisis of 2008. The volatility and fear felt by the most seasoned investors were unlike anything they had seen as the financial industry nearly collapsed. This event left investment managers nowhere to hide as the U.S. equity market, as measured by the S&P 500 Index, experienced a drawdown of more than -49%. Not only did equity performance suffer, but investors were not even able to rely on the rating agency giants like Fitch, S&P, and Moody's. Each company lost significant credibility as the validity of their ratings on different bond issues were questioned. This uncertainty reinforced the need for independent research.

The Financial Crisis also led many traditional investment managers to broaden the parameters of their investment capabilities. For example, some managers did not want to be required to be fully invested in equity markets. Other equity managers wanted the ability to invest across other asset classes, such as fixed income or alternatives, should another multiple standard deviation event occur.

This increase in flexibility to allocate assets across the investment spectrum caused research and rating companies like Morningstar to expand the number of categories and investment styles they cover. It also contributed to the creation of more alternatives and investments that were designed to have lower correlations to the traditional equity market. This combination led to an increase in the volume and complexity of offerings to research and monitor these investments, making it extremely difficult for a single financial advisor to accomplish.

WHAT TYPES OF ORGANIZATIONS UTILIZE OUTSOURCED INVESTMENT SERVICES?

The list of corporations in the financial industry that is outsourcing investment functions in their businesses continues to grow. Institutional investors, pensions, and defined contribution plans are hiring outside investment firms to conduct a variety of services. It is estimated that nearly one-half of the assets held by endowments are being outsourced to an OCIO.

WHAT ARE THE BENEFITS OF OUTSOURCED INVESTMENT SERVICES?

More recently, financial advisors and those in the investment advisory business are increasingly utilizing the services of investment consultants to help manage their clients' investments. The ability to tap into the expertise of an outsourced investment consulting firm affords many business management and fiduciary advantages, including:

- Outsourcing investment services allows financial advisors to devote more of their time to what they enjoy. This often ranges from building relationships and meeting with existing clients to spending more time on financial planning. Most financial advisors and consultants entered the industry to help people achieve their goals and not to be burdened with the need to research specific investments for their clients.
- The outsourcing arrangement is beneficial to all parties because it eliminates the logistical problem advisors face and can be accomplished in a transparent and unbiased fashion.
- The end client benefits by receiving additional oversight and collaboration for a nominal increase in cost.
- The industry strives to mitigate potential conflicts of interest between parties. For many investment providers, avoiding the appearance of impropriety is often just as important as the act itself. Advisors can eliminate this conflict of interest by hiring a dedicated resource to deliver various services and oversight.
- Outsourcing can help create an investment policy statement for the management of portfolio assets that can provide the detail and structure necessary for a consistent and independent review.
- Investment decisions that are conducted at an arms-length transaction through an outsourced investment consultant allow the advisor to promote the unbiased working relationship with the dedicated focus of the third party.

OUTSOURCED INVESTMENT SERVICES ADVANTAGES

One advantage of working with an outsourced investment consulting service provider is that many subscribe to robust research and trading software that provides the ability to obtain information only available to institutional investors. This can provide several advantages in developing strategies to build a portfolio, including:

01 The ability to buy with scale
(i.e., lower-cost share classes, meeting investment minimums)

02 Affording purchase access to limited offerings

03 Enhanced trading capabilities

04 Risk mitigation and optimization tools

05 Robust research and reporting capabilities

WHAT ARE THE DRIVERS CREATING OPPORTUNITIES FOR OUTSOURCED SERVICES TO ENHANCE THE ADVISOR VALUE CHAIN?

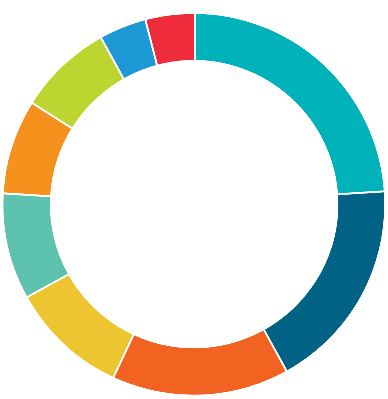
Based on collective experience and interactions with its clients and advisors, FUSE Research Network reports that advisor firms are seeking to add value across four areas: investment selection, asset allocation, planning, and solving for specific needs. Outsourced investment consulting advisory can complement their offerings with solutions in many of these areas to add value across the advisor's value chain.

ADVISOR VALUE CHAIN

	Investment Selection	Asset Allocation	Planning	Solving for Specific Needs
Value-added to client	» Control costs » Best vehicle for the given strategy	» Selection of reliable provider	» Identify client goals, risk tolerance » Asset location » Tax strategy	» Ongoing engagement and adjustments on progress to goals » Withdrawal/ drawdown sequence » Behavioral coaching
Value received from broker-dealer and asset managers	» Consistent outperformance » Compliant and without conflicts » Multi-vehicle platform scalability	» Rebalancing » Model variety » Scalability	» Account/data aggregation tools » Financial planning software	» Tax management » Transition management » Outcome-oriented models
	Previously where advisors added most value to client		Areas for advisor value going forward	

In addition, primary research conducted by the FUSE Research Network in 2022 reports that the top three reasons advisor firms prefer to use third-party investment models are to deliver better investment outcomes for clients, deliver holistic financial planning, and efficiently scale their business.

PRIMARY DRIVER FOR USE OF THIRD-PARTY MODELS



Deliver better investment outcomes for my clients	24%
My value to clients is holistic financial planning	18%
Allows me to efficiently scale my business	15%
Ease of understanding and explaining to my clients	10%
Low cost	9%
Easy to implement	8%
Better oversight, due diligence by home office or asset manager	8%
My firm suggests using these products	4%
Other	4%

WHAT ARE THE IMPORTANT QUESTIONS TO ASK WHEN CONSIDERING OUTSOURCING INVESTMENT CONSULTING SERVICES?

Experience

- What is the history of the investment consultant?
- What is their offering and which types of investment management firms have they worked with?
- What is their performance track record?
- Are their returns calculated using GAAP accounting standards?

Expertise

- Does the investment consulting provider have experience with the specific types of investments and vehicles that are necessary to accomplish the advisor firm's and their clients' goals?
- Does the potential outsourced investment services firm work with similar advisor firms, in terms of AUM size and client segments, for example?

Fees

- What is the fee arrangement and which services are included?
- Will the independent third party ensure that investment manager selection and fee negotiation interests are aligned?

Differentiators

- What key differentiators does this outsourced investment consulting services provider offer apart from others in the industry that provide increased value to the client?
- Are they a strategic or tactical investing firm?
- Do they have the discretion to pull assets out of a falling market without contacting the advisor?

IN SUMMARY

Outsourcing non-core investment management services allows today's innovative and industry-leading broker-dealers and RIAs to better support their advisors and concentrate on what they do best: Delivering sophisticated and data-informed investment strategies, building financial planning capacity, and managing intricate and complex relationships.

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