E-GUIDE

# OPPORTUNITIES FOR THE MODERN ADVISOR

Technology and alternatives can offer a competitive advantage

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WEALTHFORGE

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# Introduction

Investment advisors are a cornerstone of the financial services industry, providing valuable guidance to help grow the wealth of their clients. However, the past 10 years have brought changes that have shaken the financial world. The Great Recession and Credit Crisis of 2008 and 2009, new financial regulations (e.g. Dodd Frank, DOL Fiduciary Rule, JOBS Act), robo-advisors and other advances in financial technology, and the largest impending generational wealth transfer in history are just a few issues to contend with.

Advisors have a difficult question to answer: *How can I offer competitive service to a changing demographic in an uncertain investment environment?* While emerging challenges to the financial advisor industry are increasingly evident, there are opportunities to remain competitive and continue to add value.

Two such areas of opportunity that advisors should consider are:

- » **The adoption of technology solutions to enhance competitive advantage.**
- » **Broader inclusion of alternative assets to enhance portfolio diversification.**

# Adapting to Shifting Customer Expectations

While the financial industry as a whole is rather quick to adapt to the digital age, not all segments of the industry are equally modernized.[1] Financial planning in particular is notoriously slow at implementing new technologies. There are many reasons for this slow adoption: strict compliance regulations, cybersecurity concerns, high costs and more. But the proof is in the pudding. Advisors who have adopted new technology systems experience faster growth than non-adopters.[2]

Deloitte's 2019 Investment Management Outlook[3] report suggests that when it comes to expectations of their advisors, Millennials and Gen X are looking for sleek technology solutions. Baby Boomers are simply seeking a better customer experience. An argument could be made that those desires are different ways of expressing the same concern: that traditional, manual operating processes are cumbersome and outdated.

The report states that the two highest priorities for firms in 2019 should be creating operational efficiencies and delivering an elevated customer experience.

If your firm isn't up-to-date on technology, you're not alone. Many of these new innovations have come about due to recent changes in regulations that allow things like electronic signatures.

Deloitte surveyed 73 advisory firms on technology adoptions, and only 16 stated they believed their firm was "digitally mature," with the rest of the firms identifying as being in the "early" or "developing" stages.

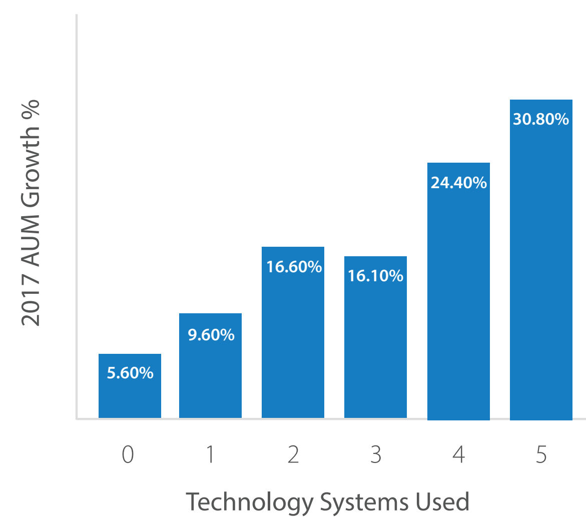
"Regulatory change is driving many firms to commit resources to evaluate and change their operating models to meet their plans for growth and efficiency," says Patrick Henry, Vice Chairman, US Investment Management leader at Deloitte.

Deloitte predicts that 2019 will be the year that tech-savvy firms will put pressure on traditional firms, and those who don't jump on the technology train will be left behind.

Advisors will, at minimum, need an online presence to keep up in a modern market. This means using web services, social media, and mobile apps to make the client experience more interactive and inclusive. It also means having an efficient and secure way to input client information into both public and private investment subscriptions without needing to mail or fax paper documents.

With only moderate adoption of technology by advisory firms thus far, and a massive impending shift in generational wealth from Baby Boomers to Millennials—a generation known for their love of technology—intrepid advisors stand to gain a potential competitive advantage by hopping on the technology train early.

***How does technology adoption impact AUM?***




Source: RIA in a Box, Today's RIA Technology Landscape (April, 2018), https://www.riainabox.com/hubfs/2018%20Tech-Landscape.pdf

# The Pillars of the Advisory Firm Technology Stack

Duncan Rolph, owner and managing partner of Miracle Mile Advisors, a technology-heavy RIA firm based in California, suggests that currently, there are 3 main pillars to an advisory firm's software stack.[4]

**Portfolio Management** – Comprehensive portfolio management not only offers a digital solution to its namesake activity, but also allows for account rebalancing, automated billing, and reporting tools to measure and present clients' investment performance.

While portfolio management systems have traditionally been designed for enterprise level firms with multifaceted needs, simpler and less expensive options have emerged to address the needs of smaller firms.

**Financial Planning Software** – Financial planning software is all about the client. A good program enables you to collect or input client data and project their financial future through a number of different scenarios. These scenarios are easily adjustable to account for unexpected events like market crashes or early death. The result is a comprehensive financial plan for the client with much less effort on the part of the advisor.

**Customer Relationship Management (CRM)** – Advisors' time is best spent actually advising clients rather than trying to find new ones. But anyone who has ever worked at a small business knows that attracting new clients is imperative to keeping the lights on. Unfortunately, it is also time consuming. A customer relationship management system allows advisors to spend less time on sales and more time with their clients.

A well-integrated CRM can help a firm organize all clients and prospects along with every interaction they have with the company. It will also allow for the automation of everyday tasks and improved internal analytics and reporting.

As younger generations begin to demand the newest technology tools for investing, advisors will have to be smart about how they implement these changes. It is not enough to have each of the requisite pieces. Advisors need a clear vision of what they want their technology to achieve, and each piece needs to work in concert with the others. That being said, a good place to start is simply knowing what those pieces are.

***Technology Adoption Rates Among Advisory Firms***

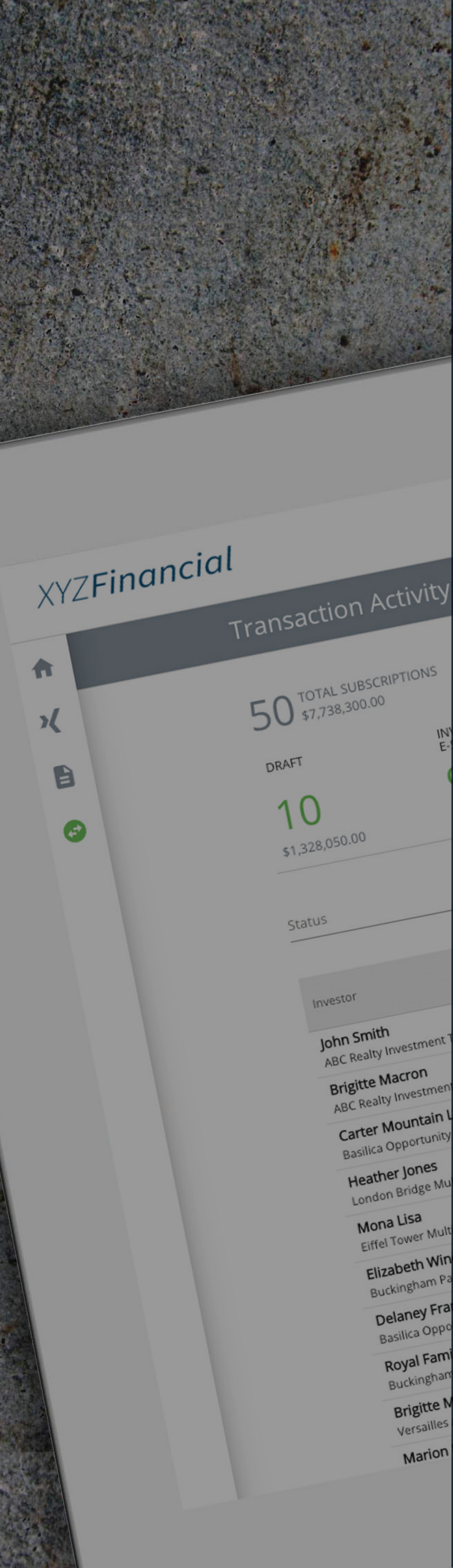
***41% of firms utilize a portfolio management system.***

***42% of firms utilize financial planning software.***

***46% of firms utilize a customer relationship management system.***

Source: RIA in a Box, Today's RIA Technology Landscape (April, 2018), https://www.riainabox.com/hubfs/2018%20Tech-Landscape.pdf

While each of these technologies is essential to addressing the modern investor's needs and easing the administrative burden on advisors, we believe there is a critical tool missing to complete the stack.




# The Missing Pillar: Straight Through Processing for Alternative Investments

The mere mention of alternative investments may bring forth a waking nightmare of paper-laden, extensive processes that are required to invest in them. While stocks and mutual funds have long enjoyed an efficient online investment process (known as straight through processing), alternative investments have been stuck in the past. High net-worth individuals are increasingly interested in alternative investments, so advisors who wish to attract them have had to put up with this painful process.

But recent changes in regulation have opened the door to the application of straight through processing technology to alternative investments. This is similar to the technology that powered FundServ and took mutual funds from minimal adoption to millions of trades per day.

With these new technology tools, advisors can skip the paperwork with a streamlined online process. This technology not only facilitates the collection of investor information by only presenting fields that are relevant to a specific investor, but also by verifying that information in real time so that advisors don't have to go back and correct the information later should the investment come back as not-in-good-order. Documents are automatically sent to investors and other involved parties for electronic signature, with no need to mail or fax documents back and forth.

***The result is alternative investments that are completed in days instead of weeks, which means a reduction in administrative rework and cycle time for advisors.***

Even time spent researching new alternative investments can be streamlined, as premium marketplace solutions begin to populate with more sophisticated investments than the traditional crowdfunding marketplaces that are rampant across the internet.

By adopting a technology-assisted investment process, advisors get the added benefit of greater transparency into their investors' progress. Analytic features can give insight into who has opened what emails and signed which pages.

While straight through processing for alternative investments is still in its nascent stages, the end-goal is the creation of an infrastructure that spans the entirety of the alternative investment process, from sponsor, to advisor, to investor, and even third-party participants, such as fund administrators and custodians. How the system integrates with custodians may be a chief concern for advisors, as alternatives that are not custodied at a major firm may not always be counted towards AUM. However, as the technology is streamlined, more custodians will able to quickly and easily get on board with alternatives.

# Common Manual Investment Shortfalls

### Rampant NIGO Rates

One of the biggest problems with manual investment processes is the frequent occurrence of NIGO (not-in-good-order) errors. In investments, insurance, or pretty much any other industry that requires paper documents to be filled out, a document is considered NIGO when it is submitted with missing or inaccurate information. Such errors then need to be corrected before the document can be processed.

According to one study, about 25 to 30 percent of financial services applications are NIGO the first time they are submitted, and the financial services firm must reject the application or follow up to correct or clarify any errors.[5] In the alternative investment space, estimates are even higher, with some industry participants claiming up to 60% of subscriptions are NIGO.[6]

Once errors are identified, the advisor must reach out to the investor to correct the documents, and the investor may even have to print, scan, and re-send the documents to the firm. This back-and-forth creates time-inefficiencies and rework for the advisor and a poor user experience for the investor.

Luckily, straight through processing technology can result in significantly more documents being submitted correctly the first time. An Intellicap report estimates that subscription automation and e-signature customers from a range of industries experience an 81.6% reduction in NIGO errors on average, with one financial services case study resulting in an 85% reduction.[7]

Because this technology is new to alternative investments, there is not yet a significant amount of literature available on statistical benefit of technology use on NIGO rates; however, one can see evidence of its resounding success in the insurance industry. NIGO rates for insurance can reach up to 75 to 80 percent.[8] The Harvard Business Review found that reducing that rate can lead to significant business gain because "a well-designed digitization program can deliver up to 65 percent in cost reduction and a 90 percent reduction in turnaround time on key insurance processes."[9] Not to mention that these reduction numbers do not capture the customer service and efficiency benefits of having a streamlined process for your customers and employees as well as a more secure and auditable subscription process.

> ***In the alternative investment space, some industry participants claim up to 60% of subscriptions are NIGO.***

### Risk Exposure

Another major problem posed by manual processes is security risk. These security risks come in many forms, but two of the most common are the risk of losing important information and the risk of someone seeing something they are not supposed to. When personally identifiable information like social security numbers and bank account information is on the line, a security hiccup can have dire consequences.

When sending documents through the mail, there is always a chance that information will be lost or delivered to the wrong address. When you are sending potentially hundreds of documents per year, even a fraction of a percent of misdelivered mail is unacceptable.

# Common Manual Investment Shortfalls

While faxing documents is more direct, it comes with its own host of issues. When it arrives, information may be open for anyone to see. Many fax machines also store PDF-like copies of incoming faxes, and without the ability to install additional security software, that information is vulnerable.

Faxing also creates the problem of multiple copies of documents floating around in various stages of completeness. This not only increases the chances that the included information will be lost or exposed, but it also makes it harder to keep track of which version is the most recent.

With both mail and faxing, there is little-to-no visibility into the progress when the documents are out of your hands. There is no way to audit who is looking at or manipulating the documents.

Using manual processes also takes a relatively long time to complete before signed and executed documents are finally stored for record keeping. The longer a document spends outside of secure storage, the more likely it is to be exposed.

Speaking of storage, if you do successfully get documents sent back and forth, signed, and executed, you then need to maintain a secure and compliant method of storing these signed documents. Physical storage solutions pose numerous security problems. Paper files stored in boxes or filing cabinets can be easily accessed and run the risk of being destroyed in a fire, flood, or other natural or unnatural disaster. There are precautions you can take, such as fire or flood proof storage, but physical storage takes up a significant amount of space, which can be costly and difficult to scale.

The loss, destruction, or disclosure of the information, even if by accident, will lead to consequences for all involved. If an advisor loses or accidentally destroys information, it could result in the investment not being processed. On top of unhappy investors, advisors may also face regulatory penalties since some records are required to be kept for a set period of time.

In the case where an investor's sensitive information is exposed, leaving them vulnerable to identity theft, advisors can face even more severe consequences. Most states have notification requirements if investor information is compromised. Failure to abide by these requirements can lead to fines. Additionally, a firm may be required to pay for identity protection for the affected investors for a period of time or if their identities are compromised, they may sue.

Having a technology-enabled subscription process is not perfect, but it can help mitigate many of these issues with features like secure delivery, version control, transparency into active processes, secure cloud storage, and data encryption.

> ***When personally identifiable information like social security numbers and bank account information is on the line, a security hiccup can have dire consequences.***

# 5 Challenges Hindering Technology Adoption

1

## LACK OF URGENCY

Baby Boomers don't expect technology solutions as often as their Millennial counterparts,[10] but as the current wealthiest generation, their preferences heavily influence the industry. However, this will change soon. Experts predict that over the course of the next 25 years, a total of $68 trillion will be inherited from older to younger generations, with Gen X and Millennials being the primary beneficiaries.[11] Not only are these younger generations more partial to technology, they also demonstrate different investing preferences with lower allocations to stocks and higher allocations to alternatives than their parents.[12] Advisors will have to adapt or risk losing relevance to a large group of potential clients.

2

## WIDENING GENERATION GAP

Even as the client base gets younger, the workforce remains older. Only 10% of financial advisors are under the age of 35, with most advisors exceeding 50 years of age.[13] When it comes to leadership, the gap becomes even wider. The average CEO in financial services is 60 years old, the oldest of any industry measured in a study by the Korn Ferry Institute.[14] And thanks to the lengthy bull market we've been experiencing, these CEOs are keeping their jobs longer before retiring.[15] Leadership of this age may be less willing to push for a risky technological change that could completely alter the way they have been doing business for decades.

3

## LEGACY TECHNOLOGY

Before the advent of cloud computing, IT systems were far more difficult to upgrade. As a result, many companies still use out-of-date systems that are incompatible with emerging technologies. Upgrading to a newer system would require a complete overhaul, which is time-consuming and very expensive. However, this type of upgrade is necessary and can save money in the future. Cloud computing systems can be upgraded remotely—without an expensive overhaul.

4

## SPEED OF INNOVATION

If it seems like technology is changing faster than it used to, that's because it is. The oft-quoted "Moore's Law" suggests that computing power doubles every 2 years, leading to exponential growth. It is completely reasonable to fear adopting a new technology, only to have it become obsolete by the time it is implemented. However, waiting indefinitely for the industry to settle on a longer-term solution can be detrimental to growing your client base as your existing technology becomes more and more outdated. In other words, you can't afford to wait.

5

## CYBERSECURITY CONCERNS

One issue that is inextricably linked to technology, is cybersecurity. This is more than just having anti-virus software on advisor's computers – it involves storing and protecting investor data. As technology gets more complex, so too do the systems required to secure it. However, avoiding technology adoption does not negate security issues. Advisors who send sensitive information via unsecured email or using exclusively paper documents both have myriad security risks that could be mitigated with proper cybersecurity frameworks and training.

# Investment Types Primed for Automation

As the desire for alternatives increases and automation solutions become more widely available, some investment vehicles are beginning to look particularly well-suited to the benefits of subscription automation technology. Three real estate investment structures in particular are gaining traction among advisors and investors interested in reinvesting capital gains efficiently, but still rely on mostly manual processes:

*1031 Exchanges*
A 1031 Exchange is commonly used to defer capital gains taxes in real estate. This exchange allows the investor to reinvest (or "rollover") gross proceeds from a sale into a new investment, without recognizing the capital gain from selling the initial investment. Replacement investments must be considered "like-kind" or in the same category as the initial investment, such as one real-estate property for another.

*Opportunity Zones*
A qualified opportunity zone fund uses proceeds to invest in property located within an area designated by the state government to stimulate economic growth within that area. Qualified funds provide an opportunity for investors to defer and potentially reduce capital gains taxes depending on how long the investment is held. Tax-basis is stepped up by 10% after 5 years and an additional 5% after 7 years. If an investment is held for 10 years, taxes on appreciation of the investment can be eliminated.

*Non-Traded REITs*
Non-Traded REITs are trusts that hold real estate assets and aim to generate returns through rental income. 90% of income is distributed to investors via dividends. REITs are not taxed on most of their earnings, as the taxes are paid by investors when they claim dividends as income.

Unlike many non-listed investments, non-traded REITs are available to the public, with no accreditation limitations. By remaining off of exchanges, non-traded REITs experience lower volatility and are less correlated to the stock market.

Each of these investment structures are unlisted and virtually the entire subscription process has historically been done via paper. The time consuming and often costly process to complete a subscription has hindered wider acceptance of these assets into client portfolios. In addition, many of these investments are not capable of being held at a custodian and therefore don't appear on customer statements. This can result in less AUM on record for which an advisor gets paid.

As a fiduciary, the most appropriate investment opportunity for a client should not be eliminated from consideration because of administrative burden. Adoption of the right technology applications by advisors can open doors that improve access to a broader menu of investment opportunities, improve client satisfaction, lower administrative costs, and potentially increase AUM.

Straight through processing aims to solve these issues for advisors and provide a better subscription experience for their clients. Lack of transparency into the status, no record of a subscription, high NIGO rates, and costly administration, can be rectified with the use of technology that seamlessly integrates into an advisor's internal processes and across other stakeholders.

# Conclusion

The challenges faced by the financial advisor community are fueling a financial technology boom. Advisors are rethinking the way they do business and introducing innovative technology solutions to streamline operations and enhance the client experience. In addition to the adoption of technology, today's investment environment is rewarding advisors and investors who think outside the box when it comes to portfolio construction and return generation.

The introduction of straight through processing technology to alternative investments has the potential to capitalize on these trends and increase the profile of attractive alternatives, driving wider acceptance. As more advisors, sponsors, custodians, and transfer agents adopt straight through processing, alternative investments will become easier and more streamlined, benefiting all involved.

If you'd like to learn more about our solutions to streamline the subscription process for alternative investments, please contact us:

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Disclaimer: Diversification does not guarantee profits or protect against losses. Alternative investments may have a long holding period, be illiquid, and contain a high degree of risk. Investors must be able to afford the loss of all of their principal. Commercial Real Estate and real estate securities are subject to risks inherent to the acquisition, management and ownership of real property, including environmental concerns, changes in economic conditions, changes in the investment climate for real estate investments, new competition, changes in the demand from competing properties, changes in local market conditions, changes in lease-up periods, changes in real estate tax rates and other operating expenses.

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