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Aggregating the World of Wealth

The Need for Consolidated Reporting

Wealthy clients tend to have multiple banking and investment relationships, and their advisors face the increasing challenge of meeting client demands and -- most critically -- growing assets under management. Today's sophisticated technology gives advisors the means to collect and process data necessary to offer clients consolidated reporting, yet many advisors still report on only a subset of their clients' assets despite these advancements. This paper describes consolidated reporting and how it is achieved today, examines the business drivers motivating advisors to offer the service, and measures the return on investment for an advisor contemplating the implementation of a solution.

Understanding Consolidated Reporting and how it is implemented

Consolidated reporting is the creation of a financial statement for an investor that encompasses multiple investment vehicles, spans marketable and non-marketable securities, captures both retirement and non-retirement assets, and provides a clear picture of liquidity through cash and cash equivalents.. A typical high net worth investor has brokerage, banking, private banking, insurance/annuity, 401(k), stock options, and alternative assets. The financial statement will reflect these assets as of a point in time, show transactions over a period of time, measure the performance of the assets (by manager, by asset type, by account type, etc.), compare these returns to a relevant benchmark, and provide asset allocation information as a key input to the financial planning process.

Behind all consolidated reporting is an accounting, reconciliation, and reporting application. Custodial data is put into the application, reconciled to ensure accuracy, and only then accessed for reporting. Data is fed into the application in one of three ways: special-purpose (“back office”) custodial feeds, manual entry from statements, or downloads from web sites. The ubiquity of financial institution websites and availability of client account information from those websites makes comprehensive consolidated reporting possible. The development of online account aggregation technology allows such reporting to be both timely and financially practical.

Implementing a successful consolidated reporting solution requires that the custodial data be comprehensive and gathered in a cost-efficient and reliable manner. Back office feeds are cost-efficient and reliable, but do not provide the necessary coverage for a comprehensive solution. Manual entry can provide complete coverage, but introduces an error-prone operation that results in disproportionately high per-account costs. With on-line account aggregation, web sites are accessed and positions, balances, and transactions are downloaded nightly, in a secure and scalable manner, enabling the advisor to achieve the desired balance of comprehensiveness, coverage, and cost efficiency.

Business Drivers behind Consolidated Reporting

Why is it so critical for investment advisors to provide consolidated reporting? The answer lies in the quest for advisors to be the 'trusted advisor' – the gatekeeper for managing their clients' assets. Clients may use multiple advisors and managers to maximize their returns and diversify their risks. But there is typically only one advisor that clients turn to for critical decisions, and this is the position that every advisor seeks. Investors look to the trusted advisor for proactive, comprehensive advice which covers investment and tax management, cash flow and liquidity planning, trust and estate advice, and risk monitoring.

To be the trusted advisor, and to provide the necessary perspective on the full portfolio of assets held by a client, the advisor must have accurate consolidated reporting. Moreover, the reporting must extend to asset allocation and performance because, without these tools, the advisor would not be positioned to offer advice on important decisions. Asset allocation is essential for maintaining the desired risk/return profile for an investor. While individual managers will report on the asset allocation for the subset of securities that they manage, the investor needs this information on a consolidated basis, so that overall diversification, by factors such as asset class, sector, industry, and issuer can be readily assessed and adjusted, if necessary. By identifying under- or over-weighted portfolio components, the advisor can create scenarios for moving assets to their own discretion. Performance measurement is the ultimate yardstick against which managers are measured, and the investor must be able to compare each manager over consistent time horizons, calibrated against consistent benchmarks. Ideally, this measurement should be undertaken separately from the reporting provided by each manager, so that the manager's reported performance numbers can be independently verified. Offering comparative performance measurement allows the advisor to identify under-performing managers and assets, thereby establishing the foundation for moving the assets to the manager's control. Systematic analysis of asset allocation and performance measurement demands consolidated reporting.

Tax preparation is greatly simplified when consolidated reporting is available. Otherwise, the investor must provide individual statements from each manager to their accountant, and the accountant must sift through the data, reconcile any inconsistencies in reporting methodologies, and effectively create a consolidated statement on their own, for tax purposes. Having the investor provide a consolidated report to the accountant is much more efficient and less error-prone.

Lastly, financial and estate planning demands consolidated reporting. Financial planning entails the matching of the investor's cash flow needs against the returns and cash flow to be provided by the investment portfolio. Often, this is achieved while testing the portfolio against various economic scenarios, such as changes in interest rates or fluctuations in market returns. Without an accurate and timely representation of the consolidated assets held by the investor, this analysis is impossible.

Consolidation Reporting Trends in the Advisor Community Today

Despite the many compelling arguments in support of consolidated reporting, its use has not been universally embraced within the advisor community. With regard to consolidated reporting, advisors today fall into four broad categories:

- Managers – these firms provide investment management, usually within a defined realm of investment types, leveraging their background and expertise. For example, managers may specialize in alternative assets, real estate, or certain asset classes. Managers are concerned with maximizing the return on the slice of assets they are given, and do not have a sufficient reason or incentive to look beyond at the investor's larger portfolio.
- Custodial Consolidators – many advisors utilize one or two 'preferred' custodians, and attempt to move their clients' assets to these custodians. Once the assets are at their preferred custodians, they can rely on the custodians themselves or their investment accounting system to provide consolidated reporting. Incentives, such as lower custodial or management fees, may be offered to investors to motivate them to move their assets. But this approach has limitations. Investors often choose their custodians because of personal relationships or for other intangible reasons, and are naturally reluctant to change. Moreover, certain investment types, such as retirement accounts, trust funds, and annuities, simply cannot be moved to alternate custodians.
- Low-tech Consolidators – once an advisor makes the decision to provide consolidated reporting, their initial offering may be based on manual aggregation, from statements or web sites. Faced with high per-account costs and a lack of scalability, these low-tech consolidators may limit their consolidated reporting service to only their largest or most valued clients, or to a limited set of accounts or account types. Low-tech consolidators cannot provide comprehensive consolidated reporting to a large number of clients.
- Aggregation Advocates – the emergence of technology solutions that offer electronic aggregation from web sites has created a new breed of advisors – the aggregation advocates. These advisors see consolidated reporting as a core component of their offering for virtually every client, and have made the investment to provide a low-cost and scalable infrastructure to support the aggregation of account data from a wide range of custodians. A subset of the aggregation advocates are those that outsource their aggregation needs. Although the per-account cost of an outsourced solution may be higher (due to the fees paid to the outsourcer), outsourcing is nonetheless a viable option that works for many aggregation advocates.

Although no comprehensive data exists on the size of each of the above groups, anecdotal evidence (based on the number of clients using commercial aggregation solutions) suggests that, if managers are treated as a separate category, the advisor community is divided into custodial consolidators (20%), low-tech consolidators (60%), and aggregation advocates (20%), with aggregation advocates being the fastest growing constituency.

Should you be an Aggregation Advocate?

Let's look at the costs and benefits implementing a consolidated reporting service using on-line account aggregation. Costs of aggregation services vary, and often include implementation and license fees. But a typical cost structure is approximately $50/account/year. In addition to these external costs, there are also internal costs associated with reconciling and monitoring the data, as well as administering the account credentials (insuring that the account numbers, passwords, and PINs are correct and current). If we assume the total cost of aggregation is $100/account/year, and an advisor earns 150 basis points on an account, then nominally an account must have a minimum size of roughly $7,000 to pay for the cost of gathering and processing the data. Of course, the advisor will incur other costs associated with the account, so the actual minimum may be larger. But $7,000 is still a relatively small account size. More importantly, the cost of on-line aggregation is fixed; it does not vary with the account size, whether measured in terms of dollars or transactional activity. Justifying an aggregation solution becomes increasingly easier as the size of the account grows. For example, with a $100,000 account, the fee to an advisor is $1,500/year, and the $100/year in aggregation cost is only 7% of the fees earned by an advisor.

By contrast, manual aggregation does not have a fixed cost structure. Assume that it takes 30 minutes per month to enter, verify, and reconcile the data for a single account. Based on $40/hour, the cost of an internal manual solution is $240/account/year. Because this fee is directly related to the number of positions and

transactions in the account, it can be substantially larger for bigger accounts. For those that are considering an outsourced solution, outsourced aggregation is often as high as $600/accont/year.

Ultimately, the benefit of an being an aggregation advocate must translate to assets under management – either attracting new clients, attracting new assets from existing clients, or (in a bad market) keeping the assets already under management. The costs of an on-line aggregation service are not high, particularly in respect to the asset opportunity with a high net worth or ultra-high net worth investor. These investors may have some accounts that fall below the break-even point for an aggregation solution; nevertheless, in the context of the overall relationship, it may behoove you to implement aggregation for all the assets, so as to insure that you are providing a truly comprehensive and automated solution.

In some situations, advisors may charge a reduced fee for assets under advisory supervision, where there is no management or fiduciary responsibility. Typically, these are retirement accounts that may lend themselves to a more passive management style. By charging for advice on these assets, advisors open an important revenue channel and strengthen their position as the trusted advisor. Even if the fee on these assets is just 50 basis points, the use of on-line account aggregation to gather the data is justified for an account as small as $12,000.

With the overwhelming majority of advisors positioning – or attempting to position – themselves as the trusted advisor, it is increasingly difficult to achieve a competitive advantage on this point through better marketing, positioning, or sales messaging. Advisors can achieve competitive advantages through better service and more efficient operations, which ultimately frees up valuable time and resources to devote to asset management and attracting new assets. Research has shown that disappointing service can prompt a shift in assets under management among wealth managers[1]. The lack of an efficient service and operating model will relegate the advisor to dealing with client service issues and operational problems. On-line account aggregation is an ideal pathway to achieve operational efficiency, and provide the consolidated reporting that is crucial to becoming the trusted advisor.

About the Author

Mr. Huebscher is a consultant serving the wealth management industry. With over 25 years of experience in the financial services market, he advises companies on topics such as new business development, strategic partnerships, market size analysis, competitive issues, and marketing tactics. On a functional level, his expertise extends to account aggregation, investment management and accounting, client reporting, reference and market data, corporate actions, and enterprise data management. He can be reached at: rhuebscher@mba1982.hbs.edu.

[1] Boston Consulting Group "Taking the Client's Perspective" – September, 2006