

The real role financial advisors play

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In today's era of professional financial advice, with regulators expecting clients to pay financial advisors for the advice they receive, the debate about what financial advisors really do for clients seems to surface more and more.

Whilst technical information about financial and investment planning is increasingly available for free on the internet (robo-advisor tools anyone?), global barometers show that the demand for financial advice keeps increasing. This would seem to indicate that financial planning involves a lot more than the simple maths of compound interest and understanding the relationship between investment risk and return.

Yet many financial advisors continue to put forward a value proposition to clients based on delivering superior investment returns through some proprietary investment management process. Such a one-dimensional advice proposition is almost impossible to sustain through a full market cycle. Surely a financial advisor's role extends beyond the delivery of superior investment returns?

A financial advisor's important role as behavioural coach was brought home to me recently during a conversation with an advisor on how their practice's internship programme has been developing. Their practice only appoints university graduates but from various university faculties. During the conversation the financial advisor made the rather interesting comment that, when it came to converting interns to client-facing advisors, they had a higher success rate with interns who had a Psychology major than with interns who had a B.Com (Financial Planning) degree. The advisor then said that they "found it easier to teach a Psychology Major the principles of financial planning than to teach a B.Com (Financial Planning) student to manage a client's behaviour".

A well-researched area

This theme of managing client behaviour has subsequently cropped up in a number of our conversations with advisors. Anyone interested in quantifying the value of financial advice will be happy to hear that a fair amount of global research has been commissioned over the past 15 years into exactly this area. Most of the research attempts to answer the following broad question: "Are there major differences in the financial position of investors who consulted advisors early on in their lives, and investors who did not. What drives these differences?"

There are four main pieces of research often cited in this space (three from the USA and one from Canada). The objective of this article is not to do an in-depth review of the results – readers are invited to study these reports directly. Skimming through the conclusions of these four reports, however, a very interesting pattern emerges:

- The *Investment Funds Institute of Canada Value of Advice report (2012)* concludes that households who consult with advisors continuously for 7-14 years end up with almost double the household assets than households without an advisor. The difference is ascribed almost entirely to the fact that **advised households have a much higher savings discipline.**



- The *US National Bureau of Economic Research into the Market for Financial Advice (2012)* highlighted the dangers of advisors who merely chase portfolio returns, or who are encouraged to ‘trade portfolios’ aggressively. It is claimed that such advisors **reinforce the negative behavioural biases of their clients, destroying value.**
- *Alpha, Beta, and Now... Gamma by Morningstar (2013)* investigated how improved income drawdown strategies could benefit pensioners. It estimated an increased portfolio return of around 1.8% p.a. through **improving the financial decision-making of retirees.**
- In *Putting a value on your value: Quantifying Vanguard Advisors’ Alpha (2014)*, Vanguard analysed the impact of various financial advisor activities on client portfolio performances. It estimated a potential positive portfolio performance impact in the order of 3% p.a. after fees from the following sources:
 01. Appropriate portfolio construction (0.75% p.a.)
 02. Ongoing rebalancing of portfolio and managing income drawdowns (0.75% p.a.)
 03. **Behavioural coaching (1.5% p.a.)**

Looking at the headline conclusions from these four research reports, one cannot but notice how every report highlights the importance of a financial advisor managing a client’s financial behaviour, decisions and discipline.

Financial advisors as financial counsellors/therapists?

Exploring some of these learnings in follow-up advisor conversations, it became clear to me that many financial advisors underestimate their role as financial therapist, and lack a plain-language way of explaining this role to a client. Yet when asked to explain how a relationship with a new client develops, most advisors intuitively point out the following steps:

- Develop a rapport with a client. Listen to their financial problems, needs and wants, and start educating the client on the trade-offs inherent in what they want, what they really need, and what is possible within the framework of the risk/return pay-off available in the market.
- Prepare a financial plan for a client taking all the above points into consideration.
- Present the financial plan to the client, and convince the client to take appropriate action.
- After implementation, review the plan at least annually, and make adjustments as necessary.

Now admittedly, this is a very broad-strokes summary of a typical client/advisor relationship. But notice how three of the four steps are predominantly about counselling a client on their finances, and getting clients to commit to changing their financial behaviour. Only step two is about the nuts and bolts of portfolio construction and financial/estate planning.

Embracing the role of the advisor as behavioural coach

It is becoming increasingly clear that a significant part of an advisor’s value-add is realised through encouraging clients to improve their financial behaviour. More and more scientific research in this area seems to be confirming this fact. This is also the one area where robo-advisor functionality continues to struggle to impress clients. As we have highlighted in previous articles on the developments of robo-advice, the combination of a robo-advisor and a human advisor is emerging as a real growth trend. No doubt the human advisor’s superior behavioural coaching is playing a big role here.

We would like to encourage advisors to recognise their important role as ‘financial therapist/coach’, and to be more explicit about this role when dealing with their clients. Advisors will probably find that clients respond very positively to this approach, and it will set them up for even better long-term client relationships.

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