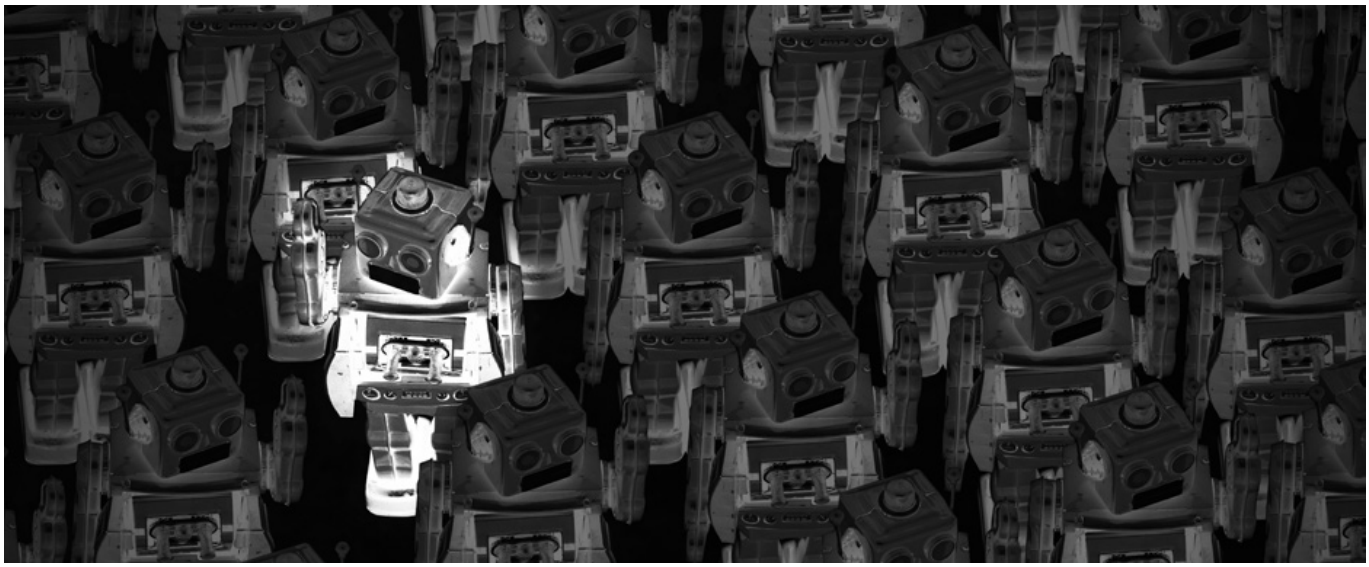

Managed accounts and technology

Bringing personalisation and scale to advisers

Bill Hortz

Will the future of investment portfolios increasingly be built, not on mutual funds and exchange-traded funds (ETFs), but on customised managed accounts? A strong trend has emerged as recent adviser surveys [conducted by fintech provider Broadridge Financial Solutions in 2021 and summarised in its *The Evolving Advice Business Model* publication] report that 62% of financial advisers use separately managed accounts (SMAs), and that number is even higher among advisers under 40 (70%). In addition, 56% of advisers who use SMAs also plan to increase their usage over the next two years.

Much of this trend is built on advisers seeking differentiation and becoming more focused on providing the best client-centric investment experience and more perceived client value. This is leading advisers to re-evaluate how best to be equipped with the right tools and investment products to service their clients and investment portfolios in this evolving financial services business environment geared to 'personalisation'.

Unfortunately, many financial advisers and wealth management firms are at the mercy of their organisations's numerous and sometimes disparate technology systems, many of which are outdated, inefficient, and error prone. Add that to the ever-changing regulatory environment pushing stringent standards often creating a maze of policies, audit, and oversight requirements that must be followed when providing investment advice.

Technology becomes the only key to opening up these opportunities and spawning the flexibility and creative innovations to investment customisation that can truly engage investors.

To better understand where the technology and implications of these trends are taking adviser business models and client experience with financial services, we reached out to Institute for Innovation Development member Mike Blundin, new CEO of Vestmark—a leading provider of portfolio management/trading solutions that enable financial institutions and advisers to efficiently manage customised client portfolios through an innovative software as a service (SaaS)-based cloud platform.

Its history of rapid and continuous innovation has enabled the … platform to deliver a streamlined solution for management, trading, and delivery of managed accounts that can propel wealth management firms to the next generation of digital investment solutions.

Repositioning to customisation

Hortz

Do you see the future of portfolio management by advisers increasingly built—not on mutual funds and ETFs—but towards more customised portfolios and implemented as an SMA or UMA [unified managed account]? Does that shift reposition or redefine the adviser of the future?

Blundin

The short answer is yes. There absolutely is a tendency towards personalised managed accounts; SMAs and UMAs. The challenge with mutual funds and ETFs is that they do not allow customisation, nor personalisation. And they can be tax-inefficient vehicles, both to simply hold, but also to transition into from a legacy portfolio.

The accelerated demand in the marketplace for customisation and personalisation is really putting a premium on capabilities that have been available in SMAs and UMAs since day one.

However, managed accounts are also rapidly evolving, adding new capabilities that they have not had historically. There is a stream of new types of investment products being built on the managed account chassis, and the key driver here is enabling technology.

It is bringing higher degrees of customisation allowing an adviser to be increasingly consultative and deliver a portfolio tailored to a client's needs. It enables an adviser to shift their value proposition away from 'stock picking' to a deeper service-oriented dialog with the client.

The role of direct indexing

Hortz

So SMAs and UMAs are gaining traction because they offer the adviser the ability to do so much more for the client—both in terms of personalisation and tax management. Is this what is also driving the current direct-indexing craze? How does direct indexing fit into this equation?

Blundin

This absolutely all ties together, but one of the interesting things here is that there are some other fundamentals driving direct indexing in addition to the desire for personalisation and tax management.

One of them is the rise of passive investing. Over the last decade, passive investing has actually grown to exceed active investing in the retail marketplace. The other, over the same timeframe, has been a correspondingly large rise in interest in sustainable investing.

Direct indexing is a little bit like the chocolate and peanut butter coming together. It is the desire for a lower-cost product, which the passive strategies bring, along with the ability to express personal preferences to put their money to work in ways investors believe in ...

The desire to reflect one's personal preferences and get the pricing power benefit of passive investing requires a degree of personalisation and customisation, and the SMA and UMA frameworks are perfectly aligned with delivering on these expectations as well as tax management. Technologies are extending these capabilities, bringing it all together to make a direct-indexing craze possible.

Building better platforms

Hortz

You and your fellow founders saw this opportunity emerging 20 years ago when you started the firm. How did you design your technology platform to enable advisers and financial institutions to efficiently manage and trade investor portfolios in expanded ways and investment arenas? What guided your tech development process?

Blundin

That is a great question and there's a lot of good anecdotes and stories from the deep past. It might interest people to know that before Vestmark, the firm's founders were involved in online personalisation in the days of dot.com 1.0, and our personalisation product at the time was part of a Web 1.0 success story. Our early personalisation knowledge and perspectives were formed in the '90s when 'mass customisation' was booming and we were building a retail and online personalisation company.

Those experiences were instructional for us in terms of what it takes to build a platform that can really achieve retail scale and deliver high degrees of personalisation, which we carried over into the financial marketplace.

One of our very early precepts was that you need to scale not just technologically, but also operationally. Individuals or teams of people need to be able to manage the personalisation of hundreds and even hundreds of thousands of accounts efficiently. And that means that you need to enable processes that are highly automated but also oriented around exception processing.

You do not want to spend time looking at or examining a portfolio that is in good order. You need to pay attention to the portfolios that have drifted far away from their targets, have pending withdrawals, or have other exceptional conditions.

We architected into the technology, right from the get-go, facilities that make it very easy to identify and correct the same issue across many accounts in one shot, with one mouse click. We have carried along that mindset throughout all of our innovations to continue to enable scalable, exception-based workflows that allow personalisation for clients.

Another one of our founding precepts, the way we looked at the platform from an architectural perspective, is that we defined retail scale as a million accounts. It led to an internal maxim, "institutional capability at retail scale".

If we were able to figure out how to implement something and make it operationally efficient at the million-account level, we were all in. And if not, our general

Bill Hortz, Institute for Innovation Development

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The quote

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perspective was that it was probably not a capability that was ready for retail yet. With this philosophy, we have steadily advanced the capabilities of the platform and maintained operational scalability.

As we move deeper into the direct-indexing space, our long-term focus on fundamentals has given us myriad advantages out of the gate. There is a large appetite for scale in the direct-indexing market, both in terms of the facility for a financial adviser and their team to manage an increasingly large book of accounts, as well as the need for the technology to be economically viable with larger books of business across asset managers or wealth management firms …

Taking stock of wider trends

Hortz

Do you see other broader demographic and marketplace trends such as impending wealth transfer from Baby Boomers and the ageing (and attrition) of financial advisers playing into these trends?

Blundin

Absolutely, and if you talk to the pundits, they will tell you that we are living in the largest generational transfer of wealth that has ever taken place. The needs, expectations, and appetites of the people who are receiving this wealth are quite a bit different from the generation that came before them, and those expectations, even now, are rapidly evolving because the pace of change and technological innovation is so quick.

Interestingly, the direct-indexing product has several attributes that are very attractive to the next generation, some that perhaps are not as fundamental or central to the prior generation. We have a generation that has grown up aware of sustainability issues in a way that has not affected prior generations, and they want to make sure that their money is being used in ways that align with their values.

Whether it is [the] Occupy Wall Street [movement] or the rise of cryptocurrencies, there is a lot of dynamism out there that is creating appetites for both investment products that are different, but also client experiences that are different. I think this is one of the other interesting challenges for financial advisers.

The industry as a whole needs to evolve services, and service models to meet the appetites of clients. It needs to embrace more on-demand, self-service, and online approaches to client engagement. As service models become more consultative, the value proposition financial advisers bring to the table is very different from the legacy paradigm.

This trend has been unfolding over time. But, especially of late, the pace of change has been accelerating; whether it be technology, online social interactions, new communication modalities, or new asset classes like cryptocurrencies.

I believe that is changing appetites more dramatically. You can even see that in the flood of private capital into a huge number of diverse fintech startups. The number of fintech startups that are out there is extraordinary, and they are attacking various aspects of this demographic shift of appetites to the way people consume financial services.

Partnering in practice

Hortz

How does Vestmark partner with advisers and wealth management firms to launch and scale fully customised SMA/UMA solutions?

Blundin

There's a lot of business variation out there, but the short answer is that just as advisers need to personalise their offering to investors, Vestmark can customise its solution and offering to do as much or as little as the financial adviser and their firm needs.

This ranges from a fully outsourced investment product where we are taking care of all aspects of administering the product, to à la carte technology offerings that integrate with adviser systems or enterprise technology ecosystems. We understand how to partition our offering in order to meet the needs of the client and optimise what they need versus the cost of the tech.

The other dimension is that we are a single platform that supports a diversity of needs. So oftentimes, a firm can replace multiple systems and old technology silos with a single VestmarkONE platform and have a streamlined experience and holistic view as a result of that.

An investor's experience on the Vestmark platform might start with a mutual fund wrap product and grow to be an SMA, or a UMA or direct-indexing product over time. A single platform that can support both the consumer lifecycle, as well as the advisory lifecycle can become a grand simplification for the adviser firm.

We consult with client firms and work with them to figure out how to structure a solution that is going to best meet their needs going forward. We also have a variety of service offerings, so any firm choosing an à la carte approach can choose from service offerings in addition to technology offerings to plug the gaps in their operational model or create immediate scale.

Moving with the times

Hortz

Any other recommendations or thoughts for advisers and wealth management firms in developing their managed accounts business?

Blundin

The most progressive advisers are thinking very carefully about what their value proposition is and how that value proposition needs to evolve. If they want to retain and grow on the back of generational transfer of wealth, things that they have done in the past may not work as well for them going forward.

As an example, there is tremendous growth in the alternatives space, with private equity and other kinds of alternative investments becoming an expectation and important part of an overall asset allocation. Crypto as a general class of tokenised or digital investment is also coming and gaining adoption. Advisers need to embrace this and build these into their overall portfolio solutions.

For the moment, retail adoption of these asset classes is small in comparison to traditional asset classes, but they are growing quickly and are inevitably going to become a dimension to clients' portfolios.

To keep pace, you need an underlying platform that will embrace new investment products, asset classes and portfolio solutions, and do it in a way that keeps the adviser and the firm operationally efficient, so they can continue to grow in a profitable way.

The data tells us that consolidation will continue, and that implies adviser practices and advisory firms will grow. As the number of financial advisers in the United States declines and drives consolidation, the assets and clients a firm will manage will expand. This demands a platform that can scale to accommodate growth, provides automation and operational scale so that firms can grow without the speedbumps of platform and technology churn. **FS**

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