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Retooling U.S. Intermediary Sales:

New Advisor Targeting Strategies

Financial advisors are using new methods to build client portfolios resulting in four new archetypes of financial advisors, with distinct and divergent needs. The growth of these emerging archetypes is driven by a secular shift toward outcomes, more investment strategies, and fee-based compensation.

The legacy advisor model, which most asset managers are primarily organized to cover, is characterized by reliance on traditional wholesaling techniques and style-box products delivered from a few scale, brand-name providers. The new advisor archetypes, which continue to grow and now control 66% of addressable assets in the U.S. intermediary distribution channel, are:

- Portfolio managers, technically-oriented investors who build more complicated portfolios and seek best-of-breed specialist investment firms across a wider range of asset classes
- Passive allocators, who focus on allocating assets among index products
- MACS outsourcers, who use multi-asset class solutions (MACS) as core products and add value tactically through satellite selection
- Home-office outsourcers, who increasingly rely on the broker/dealer's packaged portfolios and advice

Portfolio managers and MACS outsourcers will take a combined 8% of industry market share of addressable assets over the next three years. Targeting these faster growing segments will require innovative investment and distribution strategies, including highly active investment products, a differentiated multi-asset strategy, technical engagement with advisors, and robust thought leadership. Asset managers adopting these competitive strategies will realize several benefits:

- 15% increase in efficiency per external wholesaler
- 20% reduction in distribution costs

Future winners in U.S. intermediary-led fund distribution will execute five key changes:

1. Segment advisors by archetype and focus on those best aligned with product and distribution skill sets
2. Reshape the advisor engagement model to best support delivery needs of prioritized archetypes
3. Redefine product development processes around outcome-oriented portfolio construction needs rather than style boxes or indices
4. Optimize go-to-market strategies for firm positioning and branding with advisors and consumers
5. Redesign incentives to better support the retention and growth of advisor relationships

Table of Contents

A Changing Operating Environment..................2

New Advisor Segments 4

Repositioning for Success...................................9

Conclusion 16

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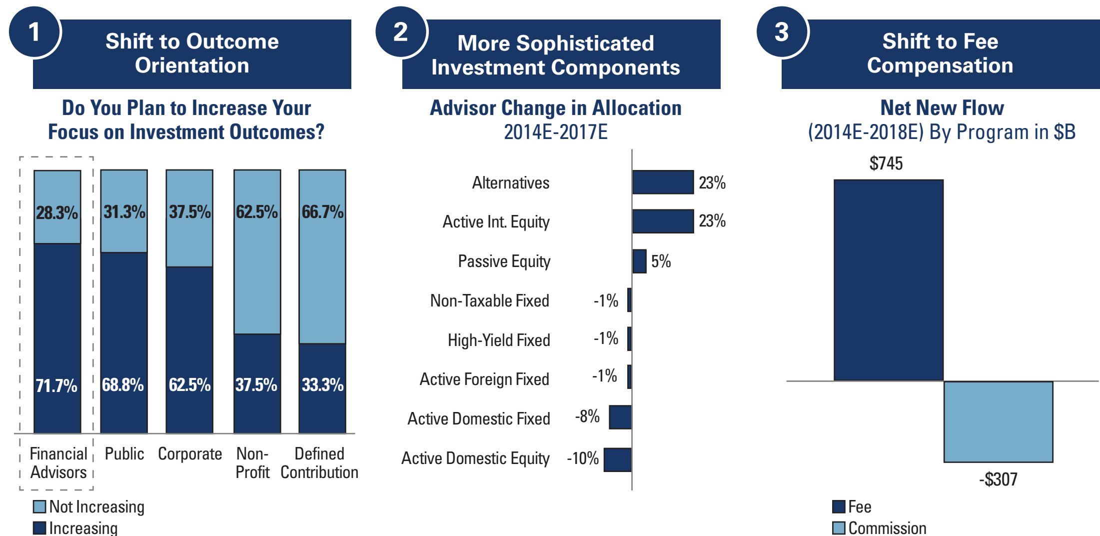
A Changing Operating Environment

Even the largest distributors of U.S. mutual funds interact with only a fraction of the 300,000 U.S. financial advisors each year. Facing resource constraints, retail distribution organizations rely on segmentation to deploy their sales force effectively. Sales forces have long segmented and targeted prospects through the means of channel, production, or assets under management. However, these factors hold little predictive insight into product, manager, or engagement preferences of the underlying advisor.

The U.S. intermediary market accounts for approximately 28% of global asset management revenues and $12.5 trillion in addressable assets. Asset managers seek to capitalize on this opportunity, but many approach the market with a "one size fits all" model that does not address product and engagement needs of advisors. Three secular changes have created divergent approaches to portfolio construction—fragmenting an advisor base previously monolithic in terms of needs and attributes.

Exhibit 1

Secular Changes Reshaping Intermediary Distribution



Source: Casey Quirk by Deloitte

- *Outcome orientation:* Most advisors have built client portfolios using a risk profile to guide allocations and benchmarks to assess performance. Following deep losses and market volatility, advisors sought to reframe investor discussions around matching risk tolerances to goals and future cash needs. Outcome-based investing has resonated with investors as a superior method to gauge personal financial risk and performance amid macro uncertainty.

- *More technical investment components:* The investable universe for advisor portfolios has greatly expanded, offering advisors more inputs to deliver outcome-focused portfolios. In addition, asset allocation has evolved from static allocations to dynamic positioning according to market conditions. New benchmark-agnostic asset categories and product structures increase the technical demands for portfolio assembly.
- *Fee-based compensation:* Increasingly, advisors have embraced fee revenue over commissions as their source of compensation. Fee relationships have grown popular because of the consistent revenue provided by asset-based fees. With revenues tied to management fees, asset appreciation drives revenue growth and frees the advisor from a transactional approach to client relationships.

In response to these changes in their operating environment, advisors have developed new approaches to constructing portfolios. Organizations that align their engagement, product development, and positioning to serve these increasingly different advisor segments will succeed in the retail market.

New Advisor Segments

Advisors are reconsidering how they build portfolios in an effort to balance the rising complexity of investor demands. In response to industry changes, advisors are presented with the choice to dedicate greater resources toward portfolio construction internally or look for methods to more efficiently assemble better portfolios.

Historically, advisors managed investment complexity by using a small number of key providers. The advisor sought well-branded, multi-capability firms, opting for deep understanding of the firm philosophy and product line-up, rather than best-in-class product for each investment. In return, consolidated relationships minimized investor costs through the use of breakpoints and exchange sales. Consequently, most advisors adopted this traditional manager selector model of portfolio construction. This shaped the industry's traditional brand-driven approach to wholesaling, built around the sale of a fund complex within which an advisor could switch between funds depending on market conditions.

But the rise of fee revenue made brand and multi-capability offerings less important in intermediary distribution. In fee-based revenue arrangements, no transaction fees apply when switching funds, negating the value of exchange sales. Additionally, fiduciary duty assumed in fee-based relationships calls for the best possible product, rather than reaping secondary advantages by concentrating positions with a single firm. Greater adoption of fee revenue has pushed advisors away from the legacy manager selector model, in search of new methods to construct portfolios.

Exhibit 2

Advisor Segmentation by Portfolio Construction Approach

		Build Organically		Leverage a Third Party	
	Legacy Manager Selector	**Portfolio Manager**	**Passive Allocator**	**MACS Outsourcer**	**Home Office Outsourcer**
Definition	• Builds portfolios utilizing a few key fund "partners"– well branded, multi-capability providers	• More sophisticated investors leveraging best-in-class fund providers, SMAs, ETFs, and individual issues	• Uses beta exposures to build bulk of portfolios	• Leverages multi asset class product as "core" of portfolios	• Portfolio allocation and manager selection decisions driven by the home-office
Value Proposition	• Simplified business model allows for deeper relationships with partner firms	• Investment sophistication	• Cost efficiency • Simplicity	• Better balance of time spent on investments vs. sales for advisor	• Practice efficiency • Value-add beyond investments
% of Total Advisors Today	34%	25%	6%	11%	17%

Source: Casey Quirk by Deloitte

Four new advisor archetypes have emerged in recent years as a result of these changes in intermediary distribution. Two center on advisors who seek to offer clients a highly differentiated investment proposition, and value customization over efficiency:

- The fastest growing cohort of advisors comprises of portfolio managers, who manage dynamic asset allocation decisions, manager selection, and individual securities at the practice level. (Not all rep-as-portfolio-manager program participants are true portfolio managers; in many cases, the majority of advisors in such a program simply recreate home office models in their portfolios.)
- Passive allocators are similar, but forgo active management decisions in order to limit their purview to asset allocation decisions, using exchange-traded funds and other index vehicles to build their portfolios.

Adoption of advisor teams, modeling portfolios, and discretionary fee programs has allowed many advisors to advance their internal investment capabilities, without a detrimental impact to client management and business development. But, a wider product selection across a broader spectrum of categories also increased the research burden in portfolio construction. Advisors whose value propositions centered on relationship management and planning sought out new methods to efficiently deliver sophisticated investment solutions without compromising their core focus.

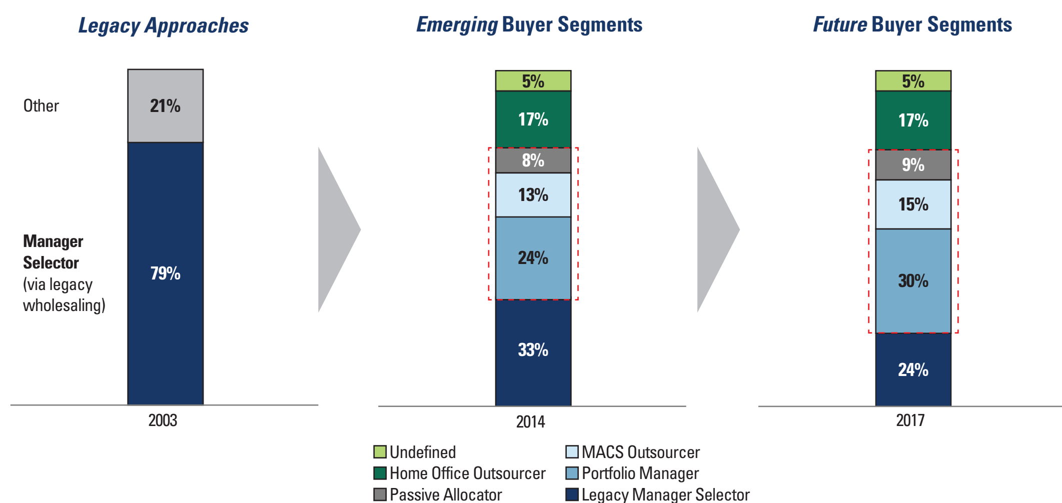
Two additional advisor archetypes outsource many portfolio assembly decisions to a third party:

- MACS outsourcers seek asset managers who offer multi-asset class solutions: Dynamically allocated outcome-oriented products. Advisors use such products as core investments within portfolios, achieving a degree of scalability in advice delivery while retaining flexibility and portability. U.S. MACS mutual funds have attracted $85 billion in net new flows for the three years ending 2013.
- Home office outsourcers remain the slowest growing archetype of advisor, even though home office advisory programs have experienced 10% annual asset growth since 2007. Such advisors rely heavily or exclusively on managed account offers established and maintained by the broker/dealer home office.

While the four new archetypes grow at different rates, together they have profoundly reshaped the U.S. retail marketplace. During the past ten years, they have grown to represent two-thirds of the US $12.5 trillion of addressable assets in the U.S. intermediary marketplace, and will continue to grow at the expense of the legacy advisor archetype, manager selectors. Secular changes in the industry have unfolded rapidly, causing a significant adjustment by advisors. Firms who continue to target manager selectors will be competing for a shrinking pool of assets, while ineffectively covering the majority of retail assets.

Exhibit 3

Evolution of Advisor Segments, by Addressable Asset Market Share

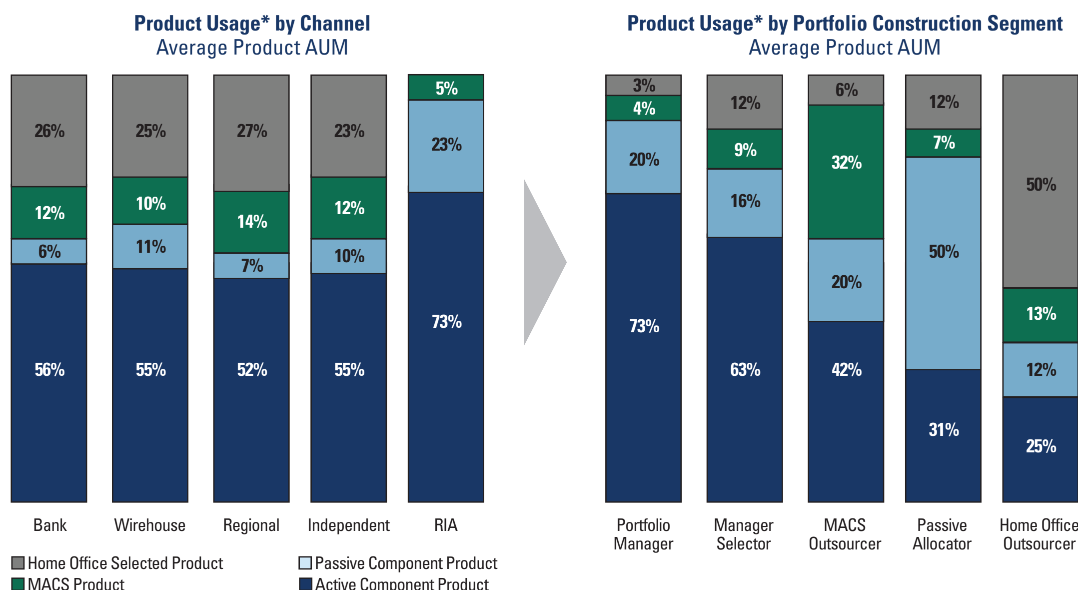


Source: Casey Quirk by Deloitte Advisor Database

Advisor transition to new models makes traditional segmentation models less relevant, particularly in terms of product positioning. A uniform approach by channel fails to isolate heavy users of MACS, passive, and home office selected product. A segmentation approach relying on advisors' portfolio construction strategies not only identifies these new types of advisors, but also determines the location of product decisions, either made in the field or through home office research teams.

Exhibit 4

Advisor Product Usage by Advisor Segment, 2013

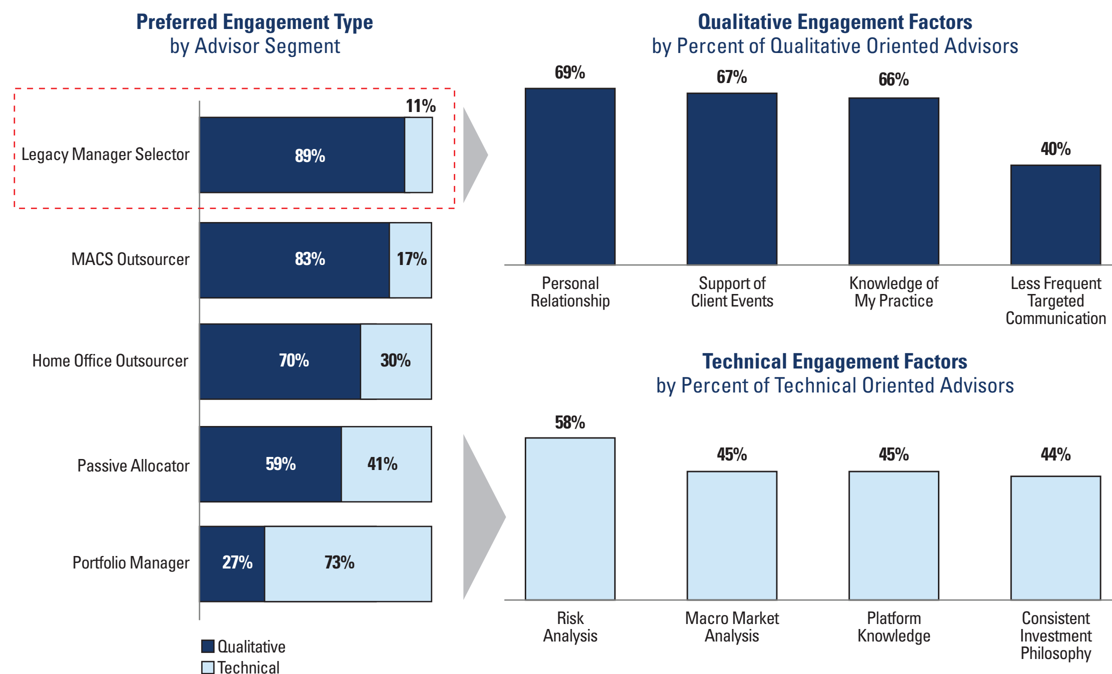


Source: Casey Quirk by Deloitte Advisor Database
*Note: *Includes mutual funds, SMAs and ETFs*

Legacy distribution models for manager selectors are brand-oriented and therefore designed to deliver standardized qualitative engagement. A manager selector's more transactional business required asset managers to visit multiple times to remain top-of-mind, and the consolidation of portfolios among a few preferred complexes resulted in intense competition for chosen provider status. Understandably this directed engagement toward personal relationship and business building support.

Exhibit 5

Advisor Engagement Preference by Advisor Segment, 2013



Source: Casey Quirk by Deloitte Advisor Database

A proliferation of investment components, more investment responsibility at the practice level, and a shifting appetite for best-of-breed product has led newer advisor archetypes to embrace (in varying degrees) more technical engagement with the asset managers and intermediaries supplying product and advice. Technical engagement delivers product-centric discussions to support manager selection diligence. Additionally, newer archetype advisors seek external macro analysis and thought leadership to supplement practice-level knowledge for allocation. Technically-oriented delivery, however, often requires greater capabilities from wholesalers, and can be more costly to deliver—making more detailed segmentation even more important.

U.S. mutual fund firms that are embracing different distribution practice to attract new advisor archetypes tend to share four key characteristics:

- A segmentation approach that aims to isolate product and coverage preferences of advisors, rather than segmenting by general opportunity size or channel
- Distinct technical sales or product specialist resources for certain advisors
- Targeted high-quality thought leadership
- Redesigned incentive systems to encourage technical engagement

The results of this distribution approach are tangible. Asset management firms implementing new fund distribution practices realize more than 15% more efficiency per external wholesaler, and as much as 20% less direct cost attributable to retail distribution.

Exhibit 6

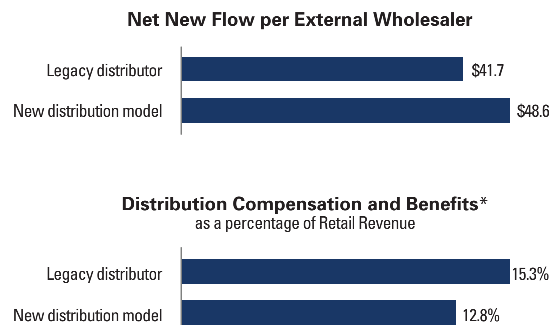
Key Financial Metrics: Legacy and New Fund Distribution Models

Legacy Distribution Factors

- Focus on relationship, tenure and value-added qualitative distribution
- Uniform approach by legacy segmentation (channel, AUM, focus firm)
- Standardized external/internal coverage model
- Product development and marketing detached from distribution strategy

New Distribution Model Factors

- Unique segmentation approach to deliver advisor's preferred engagement
- Distinct technical sales or product specialist force
- Targeted high-quality thought leadership
- Redesigned incentive systems



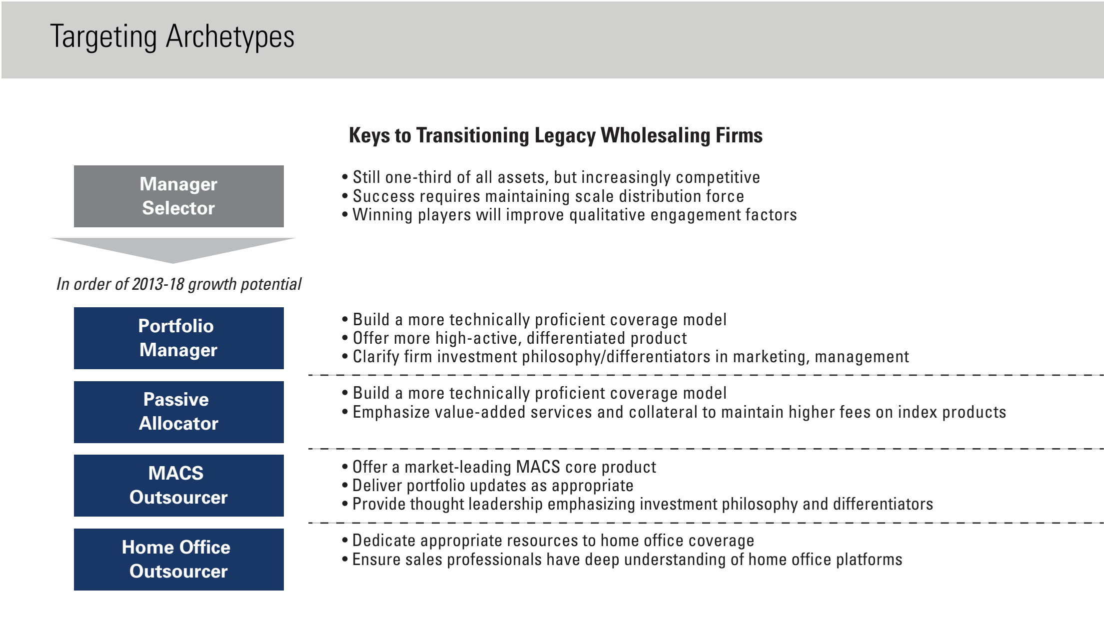
Source: Institutional Investor/McLagan/Casey Quirk by Deloitte Performance Intelligence

Repositioning for Success

Asset managers can continue to realize success focusing solely on manager selector advisors, but they will need to realize that competition will increase dramatically: the assets controlled by such advisors are shrinking, and their proclivity to use only a few preferred fund complexes will create more of a winner-take-all dynamic. Asset managers that seek to secure access to new advisors will need to think through changing core elements of their product mix and distribution strategy, depending on how many and which new archetypes they seek to target.

Exhibit 7

Targeting Archetypes



Source: Casey Quirk by Deloitte

Managing this change will require successful executive of five critical initiatives, each built to more effectively align an asset manager's competitive advantages with the financial advisors that will most demand them.

Exhibit 8

Key Change Initiatives Required for New Fund Distribution Strategies

Initiative	Description	Inputs
1 Segment Prioritization	• Segment advisors by archetype and focus on those best aligned with product and distribution skill sets	• Gap analysis: Data needs vs. CRM capabilities • Process to gather required CRM data fields • Strengths assessment: Product and Distribution
2 Reshape Engagement Model	• Reshape the advisor engagement model to best support delivery needs of prioritized archetypes	• Determine technical elements of value-add • Staffing requirements • Coverage and capability gap analysis
3 Focus Product Development	• Redefine product development processes around outcome-oriented portfolio construction needs, rather than style boxes or indices	• Gap analysis of product line-up • Organic and inorganic development assessment • Product development timeline
4 Optimize Positioning	• Optimize go-to-market strategies for firm positioning and branding with advisors and customers	• Identify key competitors • Articulate relevant value proposition(s)
5 Align Incentives	• Redesign incentives to best support the retention and growth of prioritized advisor relationships	• Incentive alignment review • Scorecard design

Source: Casey Quirk by Deloitte

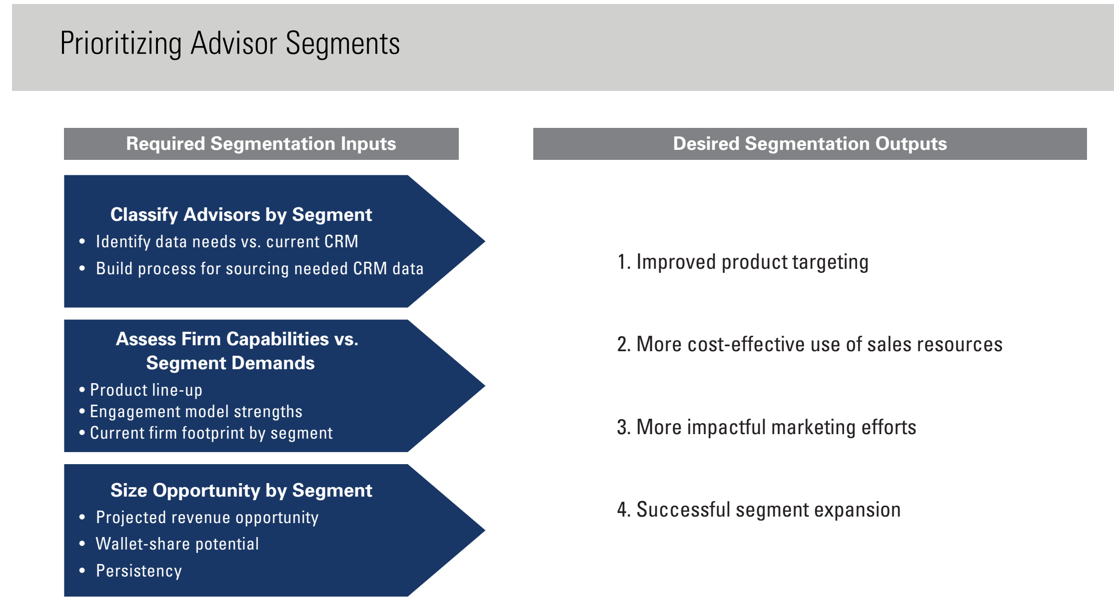
Segment Prioritization: In a resource-constrained environment, managers will find selling more products to the same advisors more profitable than selling fewer capabilities to more advisors. Effective segmentation will identify the areas with the greatest likelihood to build deeper advisor relationships. Managers should assess existing product and distribution capabilities to determine if their current positioning is appropriate. Strategic planning should then factor in the future trajectory of the firm and shifting market share of advisor segments. Implementing a segmentation approach designed around portfolio assembly practices relies upon assembling different data from existing and prospective advisor clients, typically requiring the following steps:

- Identifying the data points needed to classify advisors by new archetypes based on portfolio assembly preferences
- Assessing internal systems and client relationship management (CRM) systems to determine the availability of the required data
- Triangulating advisor segments, using best available data
- Improving source data from the field

Depending on the quality of internal data, classification may present initial hurdles. Well-designed field interactions, however, will support more customized product and service delivery. Asset managers with legacy fund distribution models actually are well-positioning for this transition: Scale field sales operations have many touchpoints with advisors each year, improving their ability to collect necessary data.

New segmentation ideas apply not only to asset managers but also to the wealth management platforms within U.S. broker/dealers, which now drive significant revenue from offering managed accounts and a menu of investment products to both commission- and fee-based advisors. Platforms seeking to extend their influence must appeal to the product and engagement needs of a broader set of advisors, which makes their own segmentation activities even more critical.

Exhibit 9



Source: Casey Quirk by Deloitte

Reshape Engagement Model: Divergent portfolio construction methods require asset managers to reassess relevant coverage models to deliver the needs of prioritized segments. Roles, technical capabilities, and coverage plans likely will change as asset managers analyze the costs and benefits of their priority segments.

- *Technical capabilities:* Wholesalers with technical capabilities come at a premium if hired externally or trained internally. Organizations should assess if their prioritized advisors truly require the incremental cost of technical distribution. Additionally, asset managers must consider where and how their technically skilled resources are deployed. Depending on prioritization, managers may deliver their technical capabilities through product specialists, specialized internal sales support, or professional buyer support.

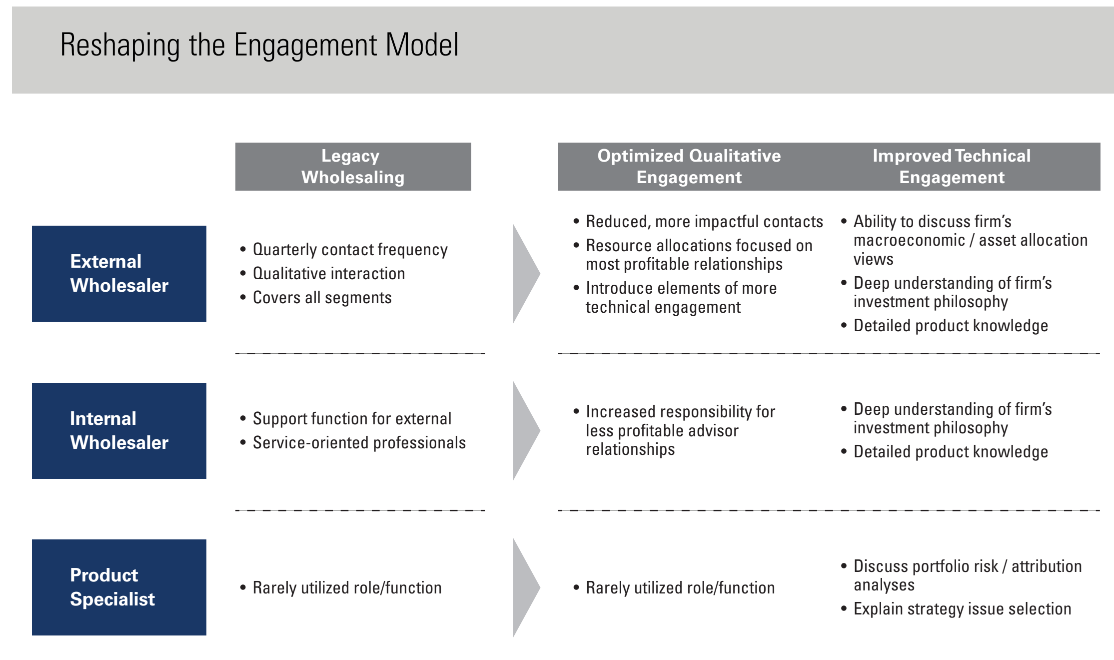
- *Staffing:* Aligning the staffing model by segment may imply customization beyond the traditional internal/external model, including specialist talent (either product or sales) and new, or different, marketing and content officers. Determining changes to resource allocation and optimal engagement delivery for prioritized segments likely will impact existing organizational charts.

- *Management:* Optimizing a sales organization targeting multiple archetypes will require dexterity from sales management, particularly within a geographic or channel-based coverage model. Clarifying the roles and coverage of a generalist/specialist approach or managing hand-offs to specialists will require both creative incentive alignment and clear leadership.

When assessing change, asset managers must decide whether they will attempt a transformational re-organization or an incremental transition toward their optimal approach to advisors. Clarifying the key factors of the engagement model within each segment will determine the feasibility and speed of transformation.

Exhibit 10

Reshaping the Engagement Model



Source: Casey Quirk by Deloitte

Focus Product Development: Retail product use has shifted away from benchmark-tracking strategies to include alternative investments and unconstrained managers. Concurrently, advisors also have become more comfortable combining active and passive components. Adoption of these products and strategies, however, is not uniform across advisor segments. Reactionary product development based on broad trends often does not resonate with existing clientele and is insufficiently supported by an unprepared sales team. Failure to apply a strategic approach causes late-to-market offerings, lacking the required track record and fund ratings, a distribution strategy to support the product, or both.

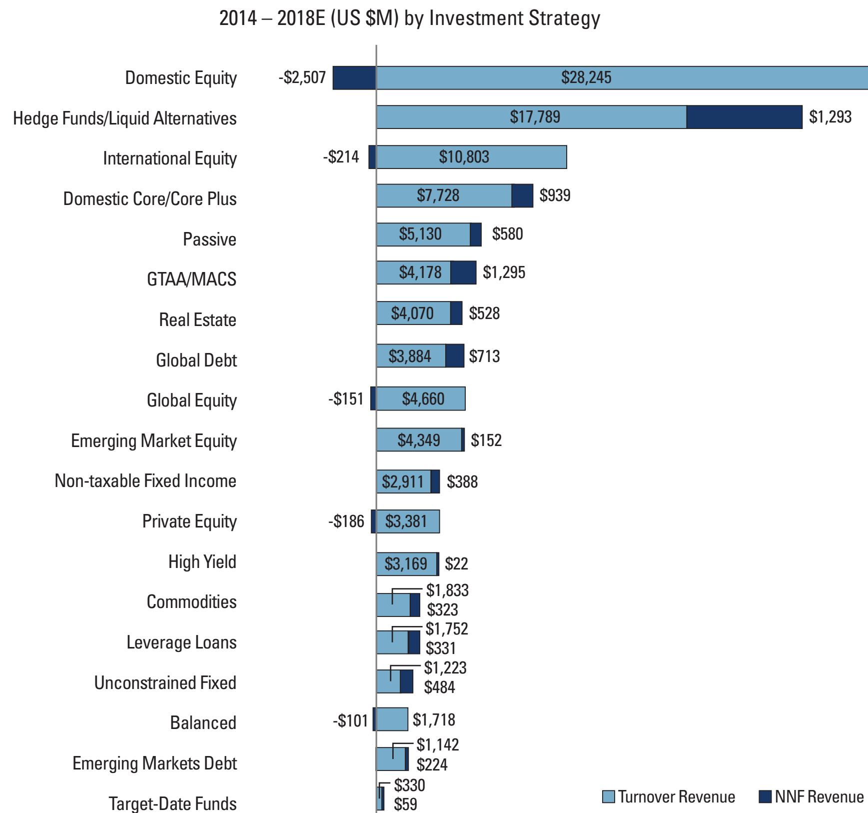
Firms can improve product development by leveraging portfolio construction segmentation to:

- Assess the existing product line-up to determine strategies utilized by prioritized segments
- Prioritize new product development to fill gaps in line-up
- Tie elements of the firm's investment philosophy and process to advisor portfolio
- Inform share class packaging decisions

Assessing revenue opportunity for the U.S. mutual fund market reveals that new flows will favor such strategies as MACS, liquid alternatives and unconstrained fixed income. However, the appetite for such products differs markedly by archetype, as outlined in the previous section.

Exhibit 11

U.S. Intermediary Channel Revenue Opportunity by Investment Strategy, 2014-2018E ($M)



Source: Casey Quirk by Deloitte Global Demand Model
Note: Includes mutual fund, SMA, ETF, variable annuity and LP revenues. Revenue opportunity includes fees from net new flows (NNF) and manager turnover.

Optimize Positioning: Branding, content, and product marketing impact an advisor's perception of an asset management firm. Adjusting positioning by archetype helps to maximize firm, product and brand impact and improve sales potential. For firms serving multiple archetypes, targeted positioning is critical to manage perception and attain brand resonance within each segment.

For prioritized groups, aligning collateral and branding with valued factors enhances in-person engagement. For the vast majority of advisors who do not interact with managers in a given year, positioning also maximizes the opportunity to generate unsolicited sales.

Asset managers approaching manager selectors framed their firm as a multi-capability provider in order to maximize their portfolio capture. However, as advisors break down allocations into smaller segments, firm positioning should pivot in response. Highlighting specialist capabilities will resonate with a portfolio manager's focus on finding best-in-class managers, whereas MACS outsourcers prefer solutions-oriented companies. Firms are not precluded from serving multiple segments, but must target delivery to avoid diluting of message and brand.

Exhibit 12

Go-to-Market Optimizing Strategies

Portfolio Construction Approach/Buyer Segment	Positioning		
	Value Proposition	Product	Content
Home Office Outsourcer	• Key partner	• Aligned with existing models	• Aligned with home office initiatives
Portfolio Manager	• Specialist	• High active	• Academic • Technical white papers
Manager Selector	• Multi-capability	• Philosophically oriented	• Firm focus
MACS Outsourcer	• Solutions	• Dynamic allocation capabilities	• Thematic macro content • Support on complementary allocations
Passive Allocator	• Low-cost provider	• Liquidity • New exposures	• Allocation tools • Macro insights

Source: Casey Quirk by Deloitte

Align Incentives: A new approach to retail distribution will only be effective if key professionals are incented to execute. Leadership, wholesalers, and national accounts professionals, among others, must be properly motivated to reposition the firm to effectively utilize segmentation.

The proposed segmented approach to retail markets requires an asset management organization to execute across broad range of functions. Specifically, changes within distribution will require significant repositioning for wholesalers. Ensuring that field engagement targets the optimal group of advisors and that conversations change to reflect a unified value proposition requires buy-in across the organization.

Retail sales forces have primarily drawn the majority of their compensation from gross sales. However, as portfolio elements such as holding period, share of portfolio, and investment decision-makers diverge, using gross sales as a default does not always align compensation with the goals of the firm.

Rewarding officers through scorecards that review other metrics more relevant to sales within certain new archetypes—including new product introduction, wallet share, and persistency of relationship—better reinforces new, targeted engagement strategies. Cost of service, revenue opportunity, and resourcing demands should inform the compensation decision. Forward-looking asset managers will address and align incentives to maximize retail profitability and push their organization toward addressing the segmented buyer.

Exhibit 13

Realigning Incentives

	Incentives	Key Metrics
Profitability	• Cost of service for each archetype • Holding period, share of portfolio and average product management fee difference by archetype	• Turnover by archetype • Asset allocation by archetype
Field Sales	• Balance of gross sales and net sales for each advisor archetype • Compensation received for placements off of preferred lists and discretionary models • Qualitative factors to measure and improve asset retention and client service • Comprehensive alteration for whole portfolio solution versus component • Incentives to maintain profitable preferred family relationships	• Staffing costs • Addressable share of portfolio • Cost of service • Training costs • Client retention • Number of products used
Management and Support Staff	• Changes to sales manager compensation are necessary to prompt change management • Internal sales incentives to support archetype service needs • Measuring key account performance in sales to discretionary platforms	• Sales management structure • Staffing allocation • Sales attribution of field and home office
Other	• Incentives to impact CRM and data collection to drive segmentation • Transition and hand-offs of advisors between coverage models	• CRM data fields • Archetype prioritization

Source: Casey Quirk by Deloitte

Conclusion

Barriers to entry, which once protected large managers, are faltering as legacy distribution methods erode. Diverging advisor preferences and needs will challenge managers who attempt to be all things to all people. Large distribution outlets, whose operations are based on outdated presumptions, will face increased competition for asset managers who implement next-generation distribution practices and targeted value propositions to individual advisor segments.

Segmenting advisors with portfolio construction attributes helps asset management firms calibrate their existing strengths and capabilities against their greatest area of opportunity. Firms will be tasked to link product development, advisor engagement, and firm positioning with advisor buying behavior. And, asset managers who advance to serve the evolving needs of advisor segments are best positioned to maintain market share and drive growth in the retail market.

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