Trends, technology help make advisors better: Study

- Just more than half, or 54 percent, of Americans trust the financial services industry. Similarly, only 51 percent of industry survey respondents said they had a "positive" impact on society.
- Whether or not the Trump administration quashes the new Labor Dept. fiduciary rule, industry and societal pressures are causing more advisors to conform to its principles.
- Younger investors want money managers to put their dollars to work in investments that do social and environmental good.

Sarah O'Brien | @sarahtgobrien

If a new study is an accurate indication of what the investment management industry will look like in a decade, investors are poised to benefit.

Released by the CFA Institute, "Future State of the Investment Profession" shows that the trends influencing how money managers and financial advisors run their businesses are pushing them toward a more ethical, value-oriented and socially responsible profession over the next five to 10 years.

Advisors "need to become customer-focused," said Robert Stammers, director of investor engagement for the CFA Institute's Future of Finance team and one of the study's authors. "They need to change from trying to beat the market to … focusing on how they meet client objectives and create better outcomes for investors."

Some of the forces reshaping the landscape range from regulatory and technology-related changes to shifting demographics and investor preferences.

The study surveyed 1,145 leaders in the investment industry around the world. Only 11 percent of respondents said their industry has a "very positive" impact on society. But 51 percent said if stronger principals were existent, there would be a very positive societal impact.

The public, too, sees room for improvement. According to the Edelman Trust Barometer, the public's trust in the broader U.S. financial services industry stands at just 54 percent. While higher than the 36 percent recorded in 2009 following the financial crisis, it remains lower than the pre-crisis figure of 69 percent.

For financial advisors, much of the ethics picture focuses on whether they are required to put their clients' interests before their own when recommending investments. Such a "fiduciary standard" is viewed by many as more ethical than one of "suitability," which only says an investment must be appropriate for a client.

Fiduciaries typically are paid via service fees, while suitability adherents typically are paid in commissions. In simple terms, the difference in standards is dictated by exactly how they are regulated.

While the Labor Department under the Obama administration jumped into the fray by adopting the so-called fiduciary rule — which requires advisors to act in their client's best interest, specifically with retirement accounts — the start date for the new regulation has been delayed until June 9 while parts of it are under review.

Regardless of the rule's fate, the industry is continuing to move toward a fiduciary environment more earnestly than it had before the rule passed in 2016. To some degree, peer pressure and client inquiries — due to greater public awareness — have contributed to the shift.

David Hays, president of Comprehensive Financial Consultants, said that in some of the advisor circles he moves in, non-fiduciaries are given less respect.

"If you aren't a fiduciary, you are kind of looked down upon," said Hays, who is a fiduciary but was not when he started his career more than two decades ago. "It's peer pressure that if you aren't one, you [had] better become one."

He also said that among new clients, awareness of the role of a fiduciary is growing.

"As little as a couple years ago, we wouldn't have people ask if we're a fiduciary," Hays said. "Now they do."

The study results suggest that serving as a fiduciary could help remove the conflicts of interest inherent to selling investment products that pay commissions. More than half — 56 percent — of the study's respondents either agreed or strongly agreed that clients are often sold inappropriate products for their investment goals. Just 4 percent strongly disagreed.

"The investment industry will be better if it puts clients first," said Rebecca Fender, head of the CFA Institute's Future of Finance team and the study's lead author.

Respondents also place importance on social, environmental and corporate governance. Driven largely by growing demand from millennials — now the largest living U.S. generation at least 75.4 million strong —73 percent of respondents expect such factors to become more important at their own businesses and the companies they invest client money in.

In other words, more investors will want to know that their hard-earned money and investments are contributing to, say, bettering the environment instead of underwriting a tobacco company.

"I think millennials want greater purpose for their money … and it's pushing the industry in that direction," Stammer said. "It's better for the bottom line. Investors know that and are starting to put pressure on companies, as well."

Financial advisor Andrew Rafal said that while he thinks the movement is still in its infancy, he's been seeing more client interest in so-called purposeful, or impact, investing.

"They want to know what is their money doing, not just what is the return on it," said Rafal, president of Bayntree Wealth Advisors.

The study also shows that investors' growing preference for passively managed funds over actively managed ones will continue unabated, with 70 percent of respondents expecting investors to increase their allocation to passive investments.

Passive investments, such as exchange-traded funds, automatically track indexes instead of relying on professional stock pickers to choose holdings, as is the case with actively managed funds.

The appeal for many investors is that ETFs and the like generally come with lower fees. That, coupled with the fact that active managers struggle to beat their benchmarks, suggests that building a portfolio largely with lower-cost passive investments can make sense.

One of the upshots of this trend is a general lowering of investment management fees.

Additionally, fee pressure is coming from technological advances. The growth of automated investment services has led to the growth of so-called robo-advisors, which compete with human advisors for investor money. Additionally, many of the services once performed by hand are now automated.

The combination has led to both downward pressure on fees charged by advisors and increased time for advisors to focus on financial areas of clients' lives that go beyond a portfolio's return.

In other words, investors are starting to get more bang for their buck.

"The best advisors are going to be the ones that understand their clients' objectives," said Fender at the CFA Institute. "An investment benchmark doesn't necessarily have much to do with people's lives.

"It's not just about one number 30 years in the future, when you'll retire," she added.