FlexShares®

The Race to Scalability 2022

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Wealth Management IQ

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Perspectives On This Survey Series

For 12 years, FlexShares has studied how and where advisors are finding efficiencies to better scale and grow their businesses, enabling them to create a better client experience. The body of data that has resulted from these surveys provides a valuable long-term look at how values, practices and outcomes have changed over a decade of rapid change for the advice business. Results of the 2022 survey add to this store of knowledge and are intended to provide insights to help advisors create efficiencies within their business and to help inform decisions when considering the use of external investment management.

This is just one of many proprietary research programs that FlexShares conducts. We encourage advisors to reach out to us for additional insights to help with practice benchmarking. We also welcome contact from asset managers for more understanding of the outsourcing advisor community.

For more details, please visit flexshares.com/outsourcing or contact us at 855-353-9383.

2022 Key Findings

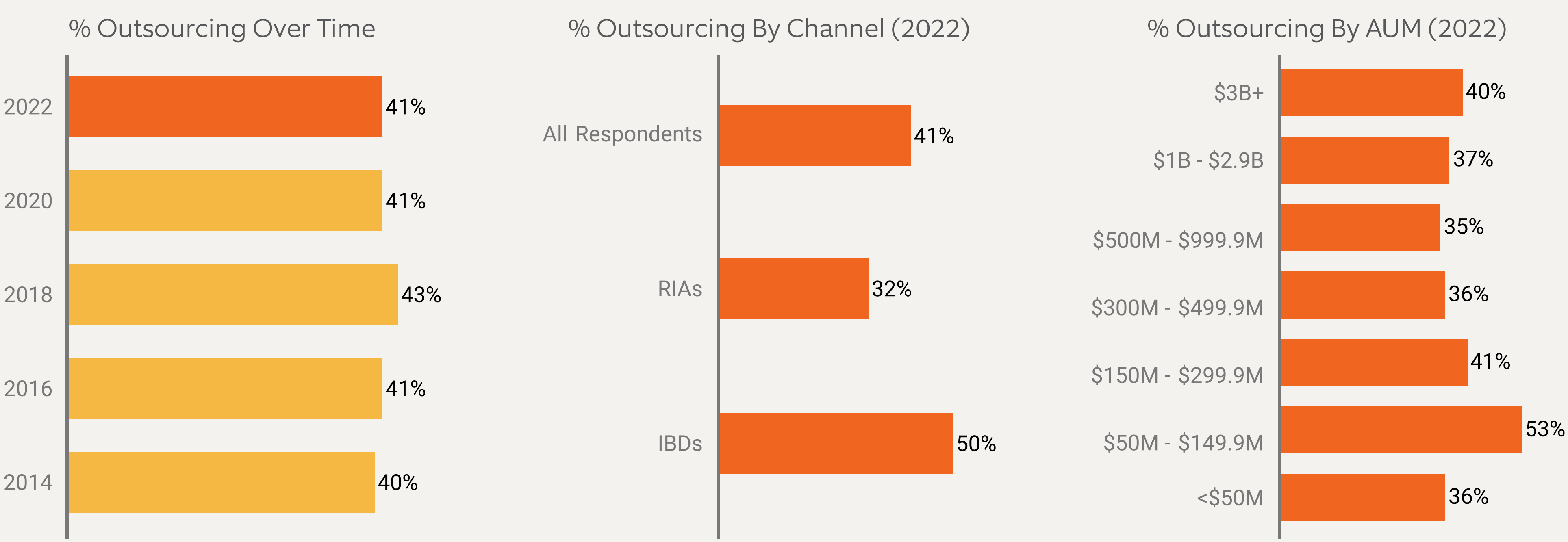
While the percentage of firms that outsource their investment management function has not changed dramatically over the past 12 years, survey data and interviews with advisors provide insights into some intriguing trends -- including fallout from the Covid-19 pandemic. These findings can help firms parse through the business, focus, and productivity ramifications of an outsourcing decision, as well as how outsourcing decision-making varies across advisor types.

Consistency in Investment Management Outsourcing Over Time

Over time, advisors' use of third parties for investment management has remained consistent. In 2022, 41% of survey respondents report that they outsource this function, almost the same as it has been for more than a decade.

The contrast between outsourcing among different advisor channels has also remained consistent – independent broker-dealers (IBDs) are more likely to outsource than registered investment advisors (RIAs). However, while IBDs are outsourcing at approximately the same rate (50%) as in 2020, 32% of RIAs now outsource compared to 27% in 2020. Interestingly, RIAs also report higher levels of outsourcing as a percentage of AUM. Since RIAs tend to be smaller and more entrepreneurial than IBDs, it's possible the pandemic pushed them to make more significant changes in the way they do business.

Outsourcing of Investment Management Activities

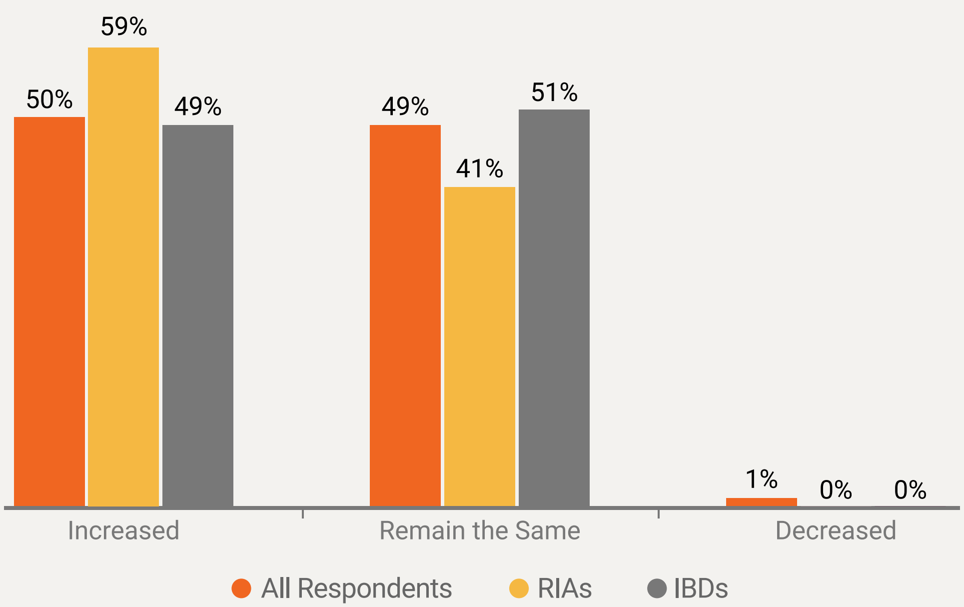


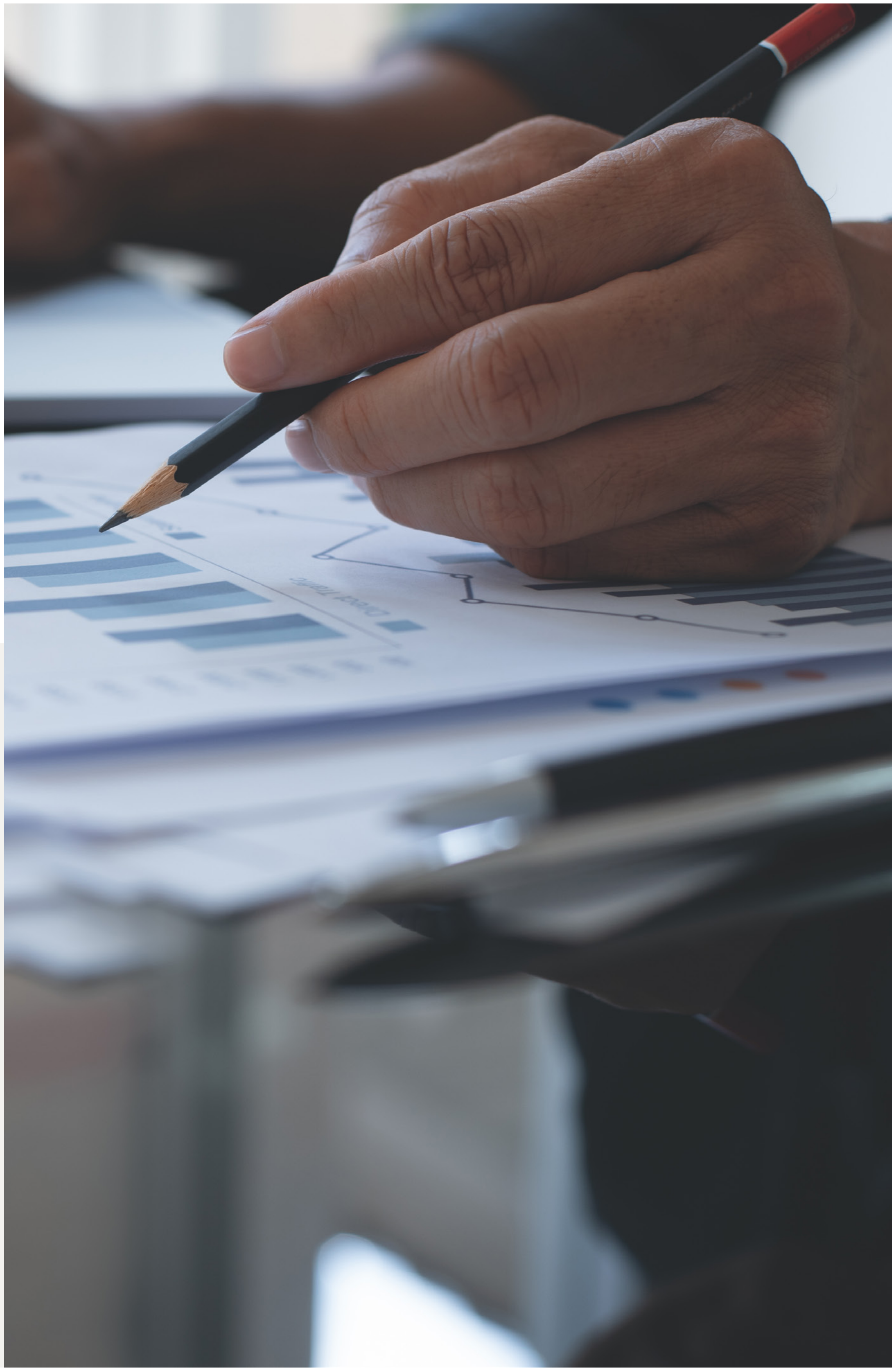
Advisors Who Outsource Investment Management Increase Their Use

While the overall proportion of advisors outsourcing has not changed, about half of all respondents who do outsource report increasing their overall use of third-party providers over the past three years. It's clear that the four out of 10 advisors who do turn to outside investment management have become more comfortable with it and are turning to it with greater frequency over time.

This trend is particularly pronounced among RIAs. They are more likely than other advisors to report outsourcing increases over the past three years. So, while a smaller proportion of RIAs turn to outsourcing as compared to other advisors, those RIAs who do outsource are rapidly increasing their use of their third-party providers. This may be a function of business size – the vast majority of RIAs tend to be smaller enterprises who needed external support to pivot and cope with recent disruptions.

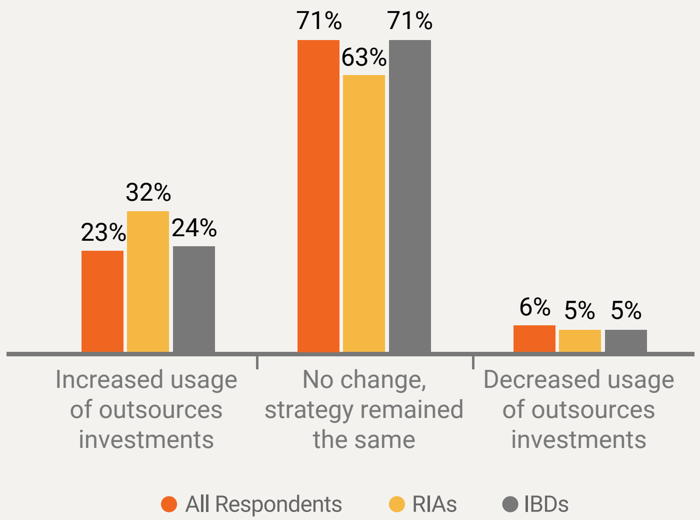
Change in Use of Outsourced Providers



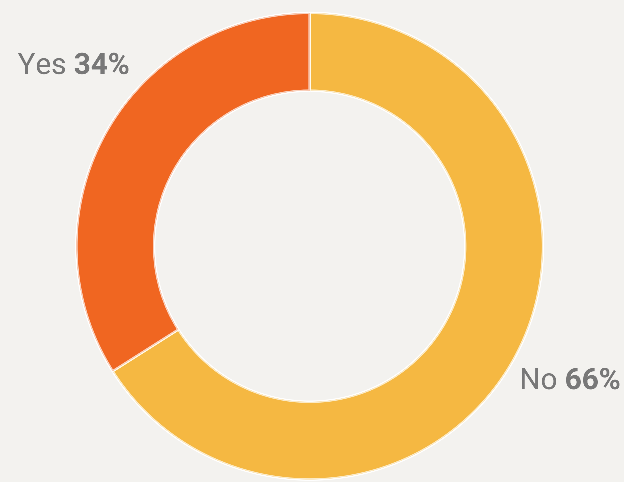


Did the pandemic prompt/influence any changes to your investment outsourcing strategy?

Impact of the Pandemic on Investment Outsourcing Strategy



Whether or Not Post-Pandemic Was First Time Investment Management Was Outsourced



Impact of the Covid-19 Pandemic on Outsourcing Investment Management

One-third (34%) of advisors overall say their firm outsourced investment management for the first time during the pandemic. It's likely that these firms turned to external managers to cope with the high turnover and instability of this period, even if they weren't comfortable with outsourcing in the past. And many of those firms that were already outsourcing knew this was a resource they could turn to in a difficult time — almost a quarter (23%) report that they increased their use of outsourcing during the pandemic.

However, a substantial number of advisors (71%) report that the pandemic has had no real impact on their outsourcing strategy.

While many advisors were already accustomed to working with video-conferencing technology before COVID-19, the pandemic forced others to adapt their processes and they experienced some challenges along the way.

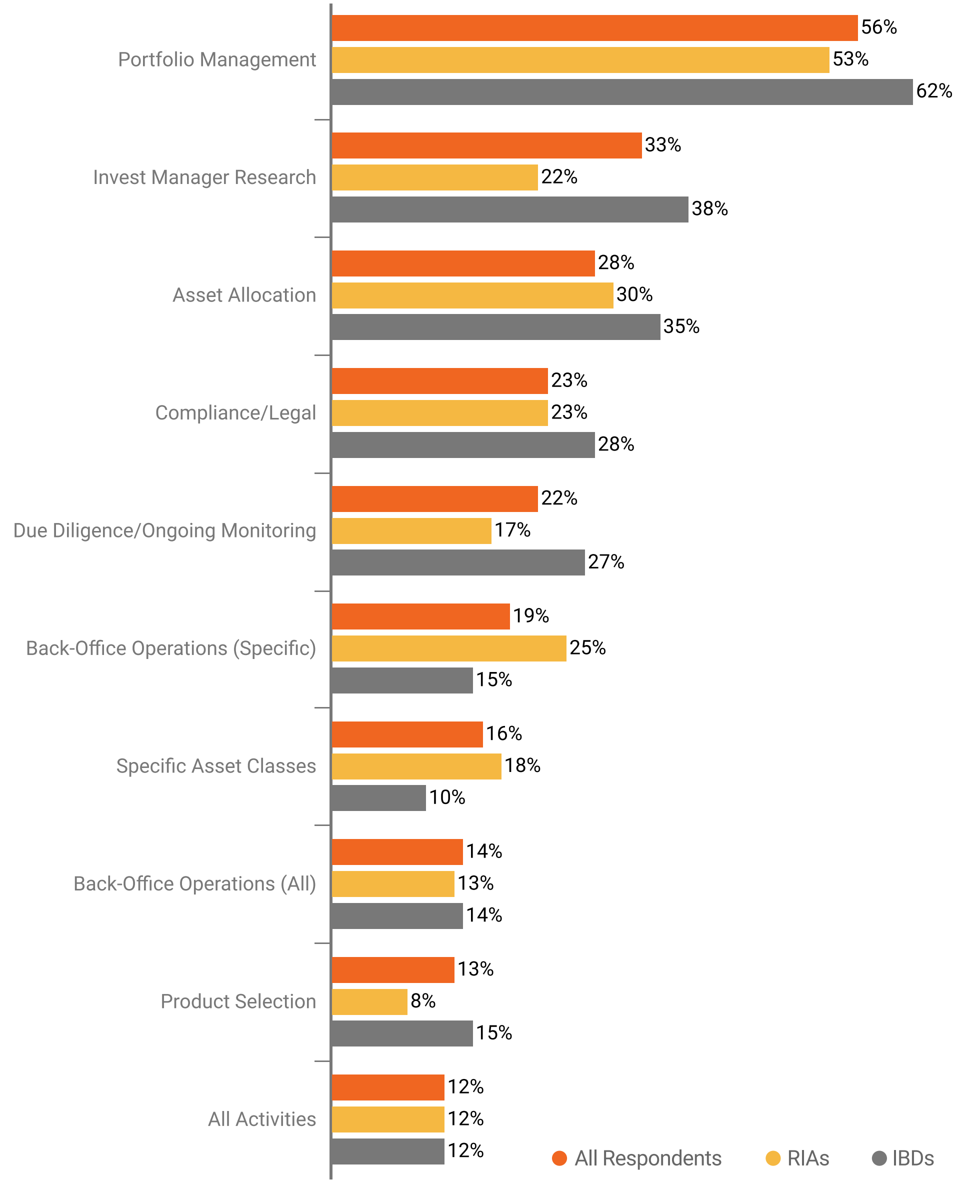
During an in-depth interview, one advisor noted that the pandemic affected how the firm identified external investment managers. "We always did [that] through databases, but a lot of the time … you meet at conferences; you meet through the managers that you have and their connections." Once the pandemic restricted travel, the firm had to explore other avenues. "There's more clients proactively reaching out as opposed to going to one place and meeting a hundred managers … So, you'd have to kind of judiciously figure out how to connect with other people."

The pandemic also complicated the next stage of the process: connecting regularly with external managers and maintaining that relationship. "Our fundamental business is finding great managers," he said, adding: "We would always go and visit them face-to-face no matter where they were in the world; we would do that once a year … The pandemic has changed that."

Variation Among Advisors in Investment Management Activities Outsourced

The majority of advisors who outsource investment management focus their outsourcing on portfolio management activities. But variations among types of advisors do crop up: RIAs are more likely than IBDs to outsource back-office operations (25% vs. 15%). By contrast, IBDs put more of their outsourcing efforts than RIAs do into investment manager research (38% vs. 22%) and due diligence or ongoing monitoring (27% vs. 17%).

Investment Management Activities Outsourced by Firm



Time is a Major Decision Driver in Outsourcing Investment Management

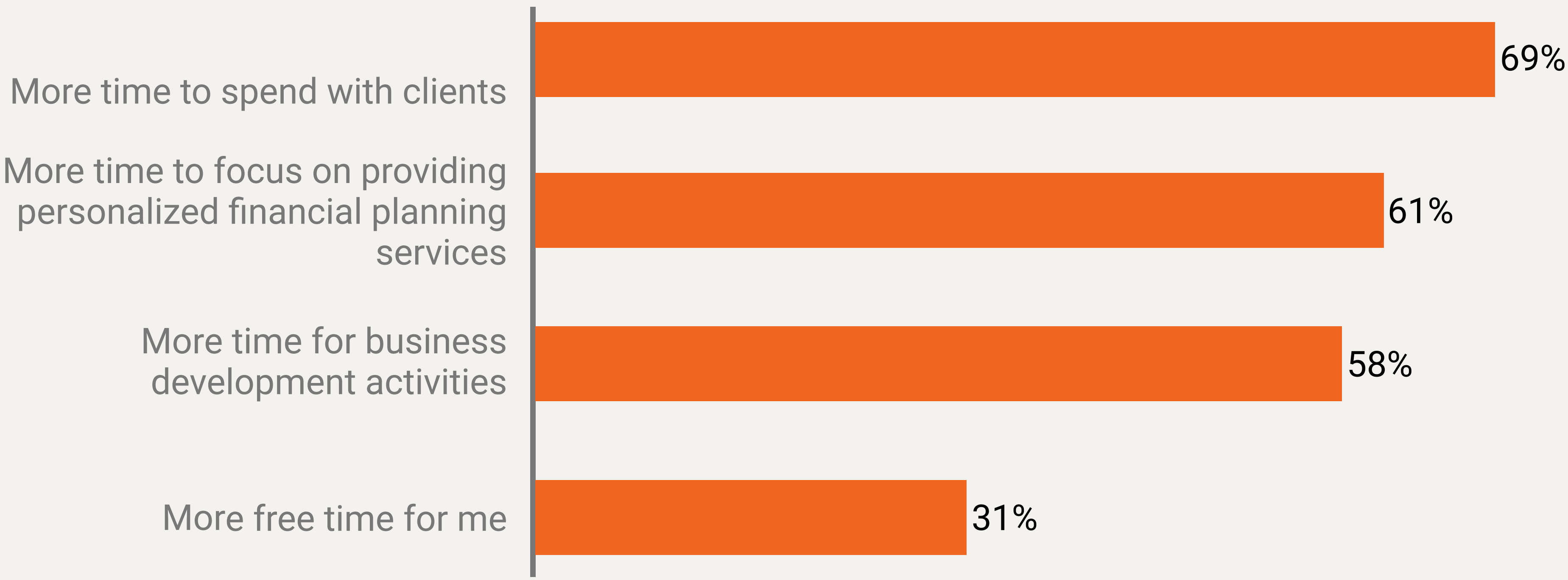
Advisors consistently rate a desire to free up time in their practice as a primary reason for choosing to use an external investment manager. This has remained true over time, but the percentage citing this factor has dipped slightly.

Upon closer examination, most of those respondents who want more time say they are looking for more one-on-one time with clients (69%) or to provide personalized services (61%), while others want the time for business development (58%).

Benefits Resulting From Use of an External Investment Manager

	2022	2020	2018	2016	2014	2012
More Time With Clients	44%	54%	63%	52%	57%	64%
More Time for Business Development	39%	49%	39%	-	-	-
Wider Range of Products	36%	38%	48%	45%	47%	58%
More Efficient Growth	32%	33%	34%	31%	51%	63%
Better Investment Performance	31%	39%	33%	34%	34%	40%
Increased Revenue	31%	28%	30%	-	-	-
Consistent Investment Management Process	30%	51%	62%	48%	51%	60%
Institutional Quality Due Diligence/Monitoring	30%	39%	50%	37%	42%	54%
Reduce Costs Associated With Managing Portfolios Internally	26%	36%	27%	17%	-	-
Improved Business Development/Acquisition of New Clients	23%	-	-	-	-	-
Support for Tactical Allocation	23%	32%	36%	22%	24%	49%
Superior Tax Management for Clients	22%	19%	26%	22%	21%	27%
Improved Client Retention Rates	20%	27%	-	-	-	-
Improved Firm Profitability	20%	28%	-	-	-	-
Containment of Compliance Needs	19%	25%	25%	23%	25%	25%
Containment of Staffing Needs	15%	23%	24%	26%	34%	42%
Containment of Tech Needs	13%	11%	15%	19%	28%	36%

Results Hopefully Achieved From Freeing Up Time By Outsourcing



Perceived Benefits vs. Expectations of Outsourcing Investment Management

A majority (53%) of respondents believe outsourcing has allowed them to increase their firms' revenues. More IBDs are confident of this benefit than RIAs, however (64% vs 52%). Meanwhile, 40% of RIAs are uncertain whether outsourcing increased their revenues. Time is also a major benefit of outsourcing cited by IBDs (50%), suggesting they see outsourcing as a way to serve their client base more efficiently. By contrast, RIAs are more likely to see better investment performance (41%) as a benefit.

Expectations and outcomes for outsourcing likely vary by advisor type. IBDs may be driven to outsource more by the prospect of time gained, which may make them more likely to attribute increases in revenue to that decision. RIAs may also see outsourcing as a vehicle for better performance and might have higher expectations for its direct impact on revenue.

In qualitative interviews, some advisors weighed in on the nuanced ways outsourcing can prove a net benefit, aside from simply providing more time to work with clients and prospects. An advisor who has relied on third-party providers extensively stated simply, "I think the best thing about outsourcing is … not so much it frees up time, but it allows you to flex when you need to. And that may be because the business is growing, or it may be because you've lost people and you need to fill a hole."

However, he adds that this approach requires research ahead of time. "You have to make sure you have those good relationships early on … It's hard to just to go in fresh and [say] 'I've got to find somebody.'"

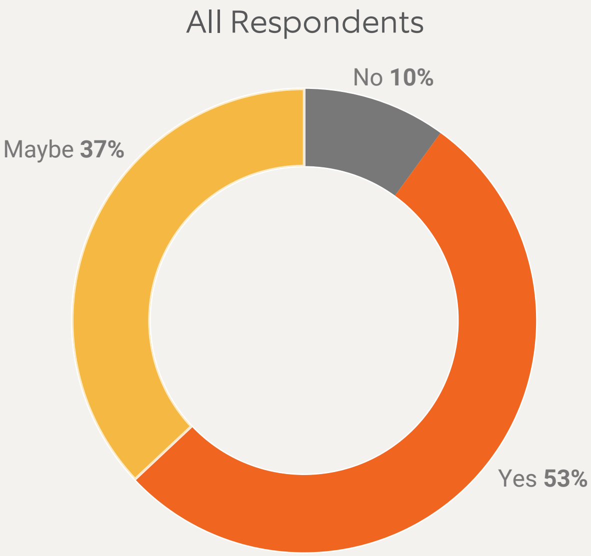
These insights may explain why those who outsource already are increasing their reliance on external managers, whereas those who don't outsource are unlikely to change their minds — the learning curve to find and build those relationships may simply look too steep.

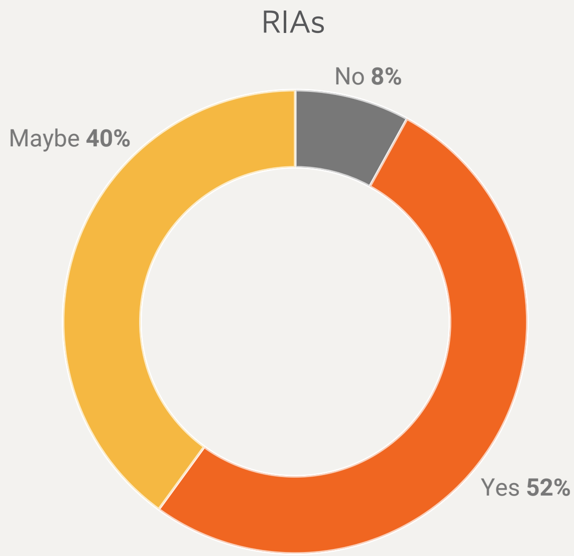
Portfolio Types and/or Investment Strategies That Are Outsourced

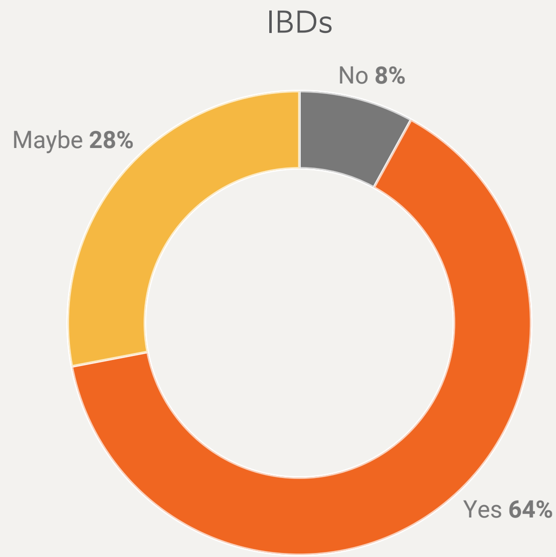
Top-3	RIAs
Better investment performance	41%
Increased revenue	36%
More time with clients	34%
Wider range of products	34%

Top-3	IBDs
More time with clients	50%
More time with business dev.	47%
Increased revenue	40%
Wider range of products	36%

Whether or Not There Was an Increase in Firm's Revenues From Outsourcing







The Value of Investment Advice

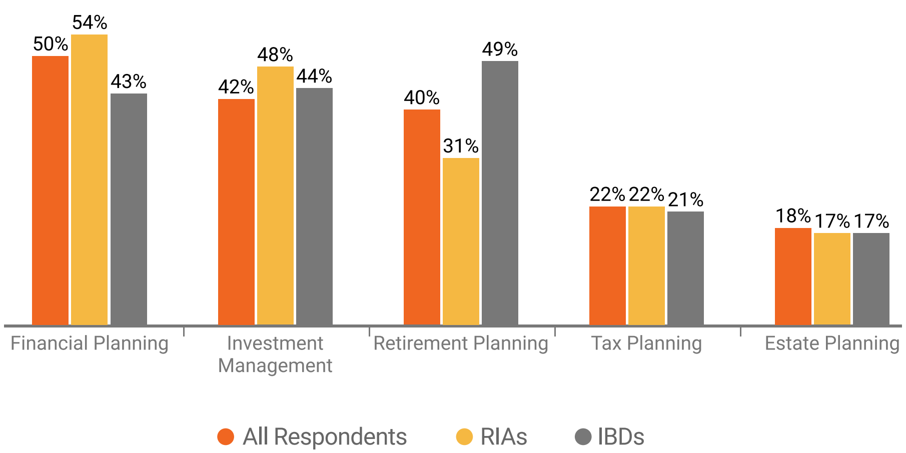
Perceived Value of Investment Management to Clients Versus to the Firm

Advisors have varied perceptions about the value of different types of wealth management services for their clients and their firms. Respondents believe investment management services deliver the most value to their firms (52%), followed by financial planning (43%), and retirement planning (37%).

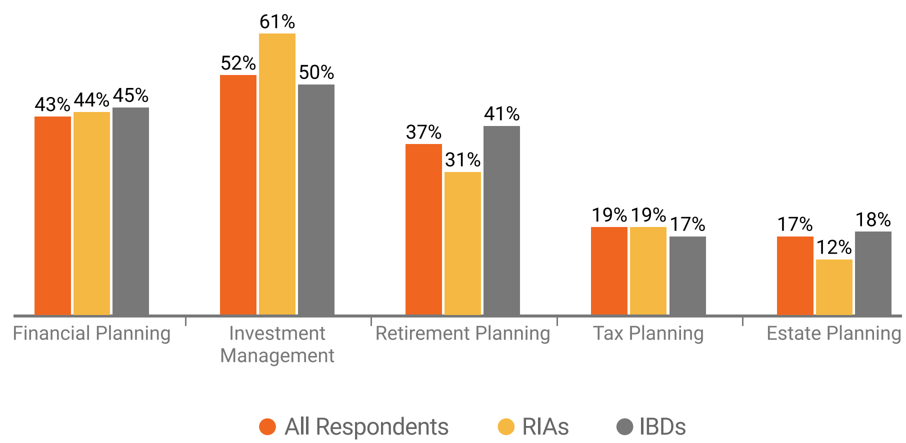
However, when asked about the greatest value for their clients, financial planning services come out ahead (52%), followed by investment management (42%) and retirement planning (40%).

While providing investment management offers advisors direct economic benefits due to the relatively high asset-based fees they generate, advisors believe services such as financial planning provide more of a premium service and value to clients. Moving forward, if more firms opt for the financial planning model and are challenged to differentiate based on their investment management capabilities, this could potentially lead more firms to outsource their investments and focus more on bespoke planning services.

Wealth Management Services Believed to Deliver Most Value to Clients



Wealth Management Services Believed to Deliver Most Value to Firm



Deeper Relationships as a Business Objective

When it comes to advisors' business objectives, half want to deepen relationships with clients and 45% want to increase revenues. Building relationships beyond the investment portfolio may prove critical to these dual objectives, which could require advisors to hire more client-facing staff and provide offerings such as estate planning.

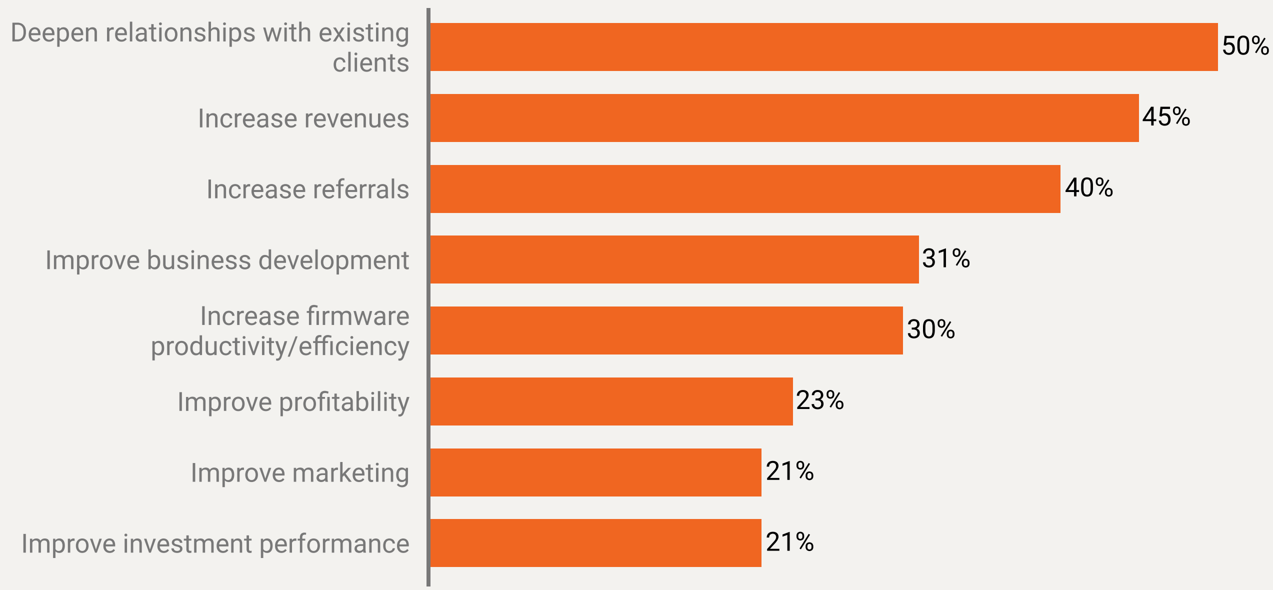
One advisor said that establishing a connection to other professionals has been a particularly successful way to build relationships. "I think the biggest thing is making introductions to other professionals that are helpful to them — for example, we've referred people to estate planning attorneys, commercial real estate attorneys, CPAs," he said. He recalls that the response from clients to those introductions has been overwhelmingly positive.

Another advisor talks about the opportunities they've been able to give clients beyond traditional offerings. "We always try to be proactive about reaching out ... But if they're really great clients and they have large amounts of money with us, we have in the past given different clients fee breaks ... If we launch new funds, we give them opportunities to get into seed funds at a lower rate and at a shared revenue."

As another advisor notes, "I think that once the client sees a value, then [that] definitely opens up the door for you to come into that part of their life."

These varied responses emphasize that relationship-building is inextricably tied up with time: Deeper relationships require a great deal of contact and can't be built instantaneously. And time is a limited resource for most advisors. Outsourcing can provide the missing link, especially considering that a major decision driver for outsourcing is the desire for time with clients and for more personalized services.

My Firm's Top 3 Business Objectives in 2022



Investment Management as a Core Differentiator

Using third-party investment managers remains popular -- 95% of those who do rely on them report that they are satisfied or very satisfied with the solution. Nevertheless, almost six out of 10 advisory firms keep investment management in-house. This proportion has remained consistent and reflects a perception in the industry that investment management is a core differentiator and a key aspect of firm identity. That said, affordability is no longer the main factor keeping more firms from joining the trend towards outsourcing.

Identity drives decision not to outsource investment management

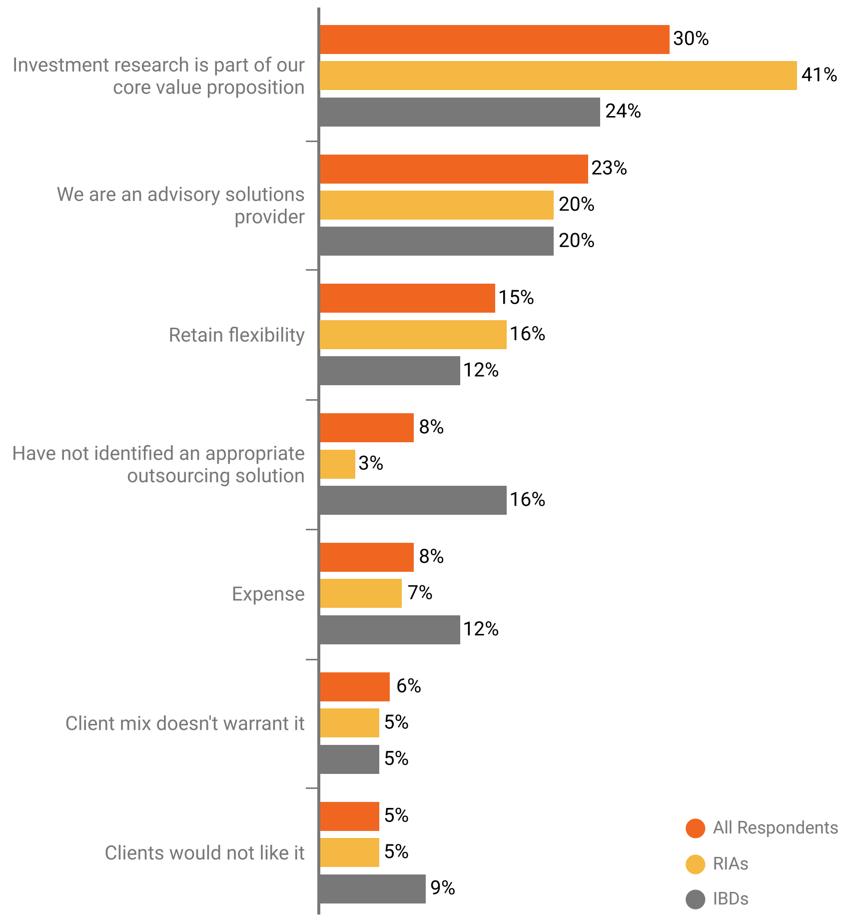
Among firms that have decided not to outsource investment management, the belief that investment research is a part of respondent firms' core value proposition (30%) remains the most voiced objection. However, the popularity of this rationale has been declining over time – from 52% in 2012 to 33% in 2020 – and in 2022, it reached its lowest level yet.

However, it's worth noting that among RIAs specifically, the core value proposition rationale shoots up to 41%. For them, identity is an even bigger part of the decision not to outsource. That said, even among RIAs, it has generally trended downward since a high of 56% in 2016.

Three in 10 advisors still choose not to outsource because investment management is a core value proposition for their business. But half want to deepen client relationships as an important business objective. As our in-depth interviews confirmed, deeper relationships can't be built on portfolio performance alone.

This becomes even more complicated in a volatile market situation. Wealth managers have more opportunities to outperform algorithmic advice when the market is more turbulent, and thus differentiate themselves based on performance. However, clients may not see the gains they're accustomed to, and wealth managers may want to offer them services beyond the portfolio to keep their business. Investment management may not continue to be such a compelling core differentiator in these times. This may motivate some advisors to turn to outsourcing to free up time for more one-on-one contact with clients in order to build trust and deepen relationships.

Reason My Firm Chooses Not to Outsource Investment Management

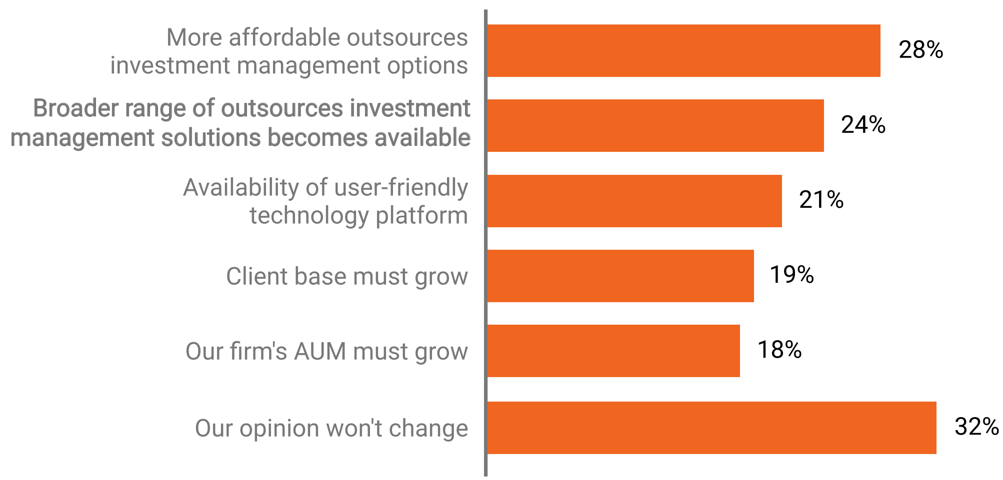


Affordability Versus Range in Investment Management Outsourcing Considerations

While 53% of respondents are not currently considering outsourcing investment management, they have not ruled it out. Moreover, two-thirds of respondents (68%) appear open to reconsidering investment management outsourcing under the right circumstances. The number of firms absolutely ruling out investment management outsourcing has trended downward over the past five years as organizations have become more open-minded about the practice.

Why would an advisory firm reconsider outsourcing investment management? In 2020, a third of advisors wanted these solutions to be more affordable – this consideration has now dropped to 28%. Instead, this year, the importance of a broader range of solutions is favored by almost a quarter of respondents, compared to 17% in 2020 and 14% in 2016. While affordability is still the most important factor for firms reconsidering their approach, that focus on cost appears to be receding in favor of the quality of options available. It's possible that, with increasing market volatility, advisors are seeking out a broader range of solutions for their clients.

Developments That Would Lead Advisors to Reconsider Outsourcing



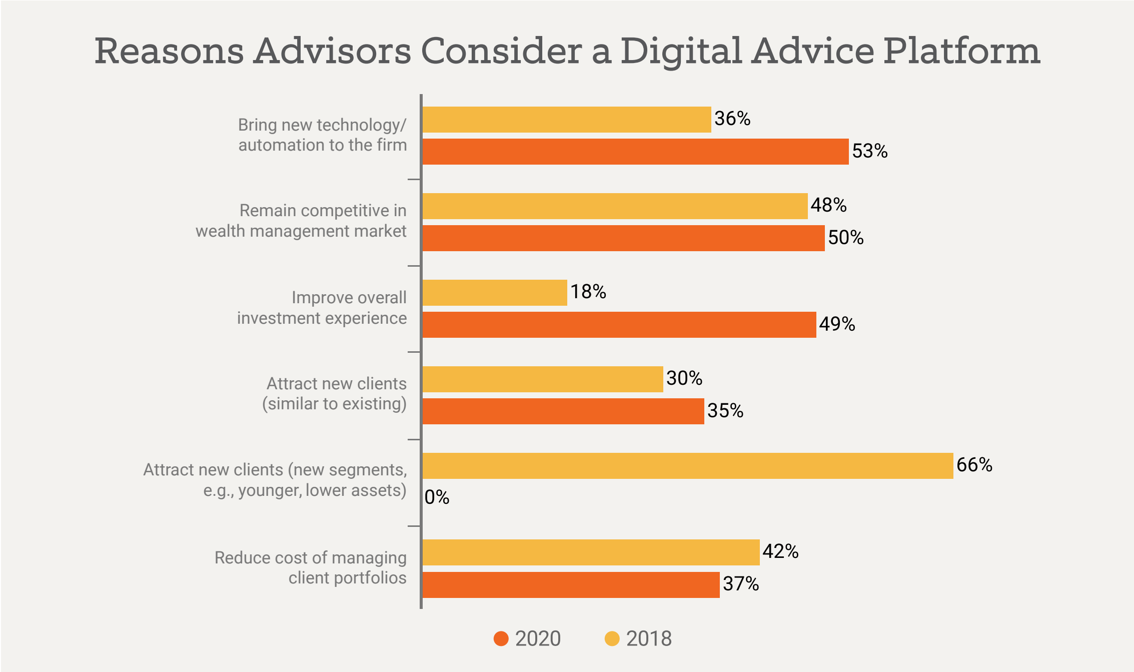
	2022	2020
More affordable outsourced investment management options	28%	34%
Our opinion won't change	32%	30%
Broader range of outsourced investment management solutions becomes available	24%	17%
Availability of user-friendly technology platform	21%	17%
Our firm's AUM must grow	18%	14%
Client base must grow	19%	13%

The Slow Rise of Wealthtech Platforms

While the "Rise of the Robos" has not materialized as expected, interest in using broader WealthTech platforms is increasing and could become a strategy more firms use to offer low-cost – and scalable – services to clients. For now, very few respondents are using a WealthTech platform (16%), but another 22% are planning to do so within the next two years.

In 2020, a majority of firms (53%) cited new technology and automation as their top reason for deploying a WealthTech platform. In 2022, that number has fallen to 40%, behind remaining competitive in the wealth management market (46% in 2022 vs. 50% in 2020). Attracting new clients in new segments has also gained prominence among advisors, cited by 41% of respondents in 2022.

Absent an external catalyst, firms seem generally satisfied with their current WealthTech offering. In 2022, they cite a need to see increased demand from current clients (38%) as well as increased demand from prospective clients (36%) as the top reasons they would consider changing WealthTech platforms.



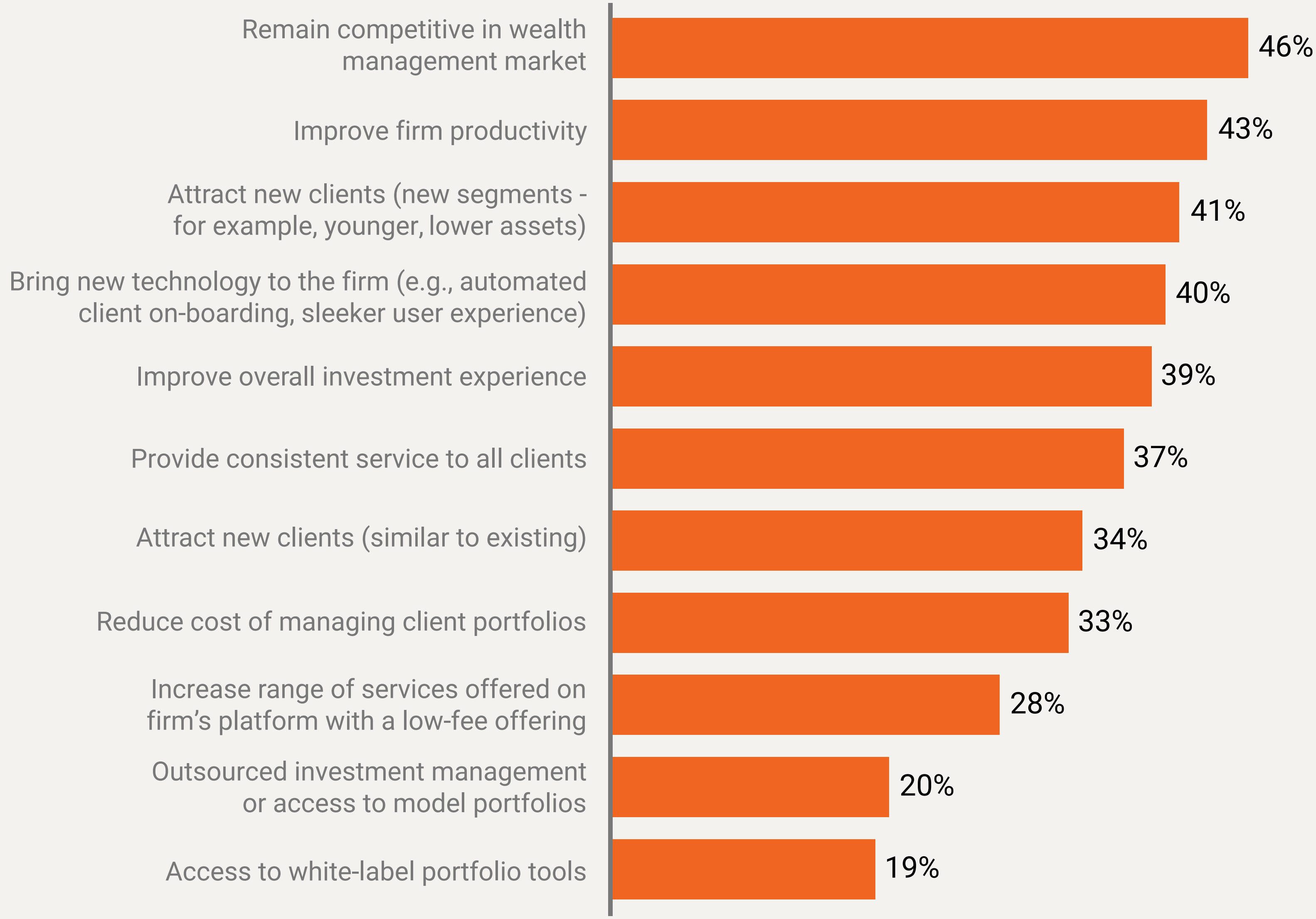
Though advisors are increasingly relying on digital advice platforms, the definition of "WealthTech" is still opaque to some. One advisor says such platforms that link accounts are often too intrusive for many clients and as a result, his firm avoids using them in favor of reporting software only.

Others, however, say they rely heavily on digital platforms, but with some reservations. One advisor notes that these platforms offer scalability but are only useful if used often enough to become familiar. "Unless you're using it day in and day out, you really don't get the maximum benefit of it," she observes.

Several advisors cited cost as a major barrier to adopting more platforms. One says: "Whenever you do anything in technology, it always costs a lot more than you think. So that's always the No. 1 and it always takes longer than you expect."

He also expresses caution about "robo advice" platforms. "I think you always have to be careful about providing advice through robo shops because the SEC has very particular rules around how we advise … You don't know who's relying on that investment advice … So, if you're providing investment advice to someone that you don't really know that well, I think you're going to get in trouble as a registered investment advisor."

Firm's Primary Drivers for Utilizing a WealthTech Platform



ESG Investing

Growing Interest in ESG and the Need For Expertise

During in-depth interviews, advisors spoke to the growing demand for Environmental, Sustainable and Governance (or ESG) investment strategies.

“It was natural for the institutional investor to give you those directions,” one advisor recalls. “But recently, you’re hearing it more coming from the individual investor.”

Recent data backs up this anecdotal evidence. A November 2021 survey of investors demonstrated widespread interest in ESG and revealed a gap in advisor recommendations – 72% of respondents said they were somewhat or very interested in sustainable investing but only 13% had received ESG suggestions from their advisors. Instead, investors are exploring this area on their own by consulting media sources and other research. Others still are open to the possibility -- 57% of investors who aren’t currently interested in ESG said they would change their minds if their advisors suggested it.

One advisor who worked at a firm with extensive ESG experience speaks to the changes he’s observed in this area over time. “ESG has matured. Certainly, the last five years, renewable energy and climate change has kind of become the No. 1 ESG issue … So, we have pivoted a little bit more. We’re seeing most of our growth -- from a volume standpoint -- coming from that area.”

Other advisors feel less secure venturing into ESG because of the lack of standardized procedures. “I’d call it a dubious process because I couldn’t find a definitive measurement tool,” one advisor notes, adding, “So I think the whole business is kind of the wild, wild west right now. And because of that, I don’t want to be in it.”

The growing demand for more ESG investment products sits in stark contrast to advisors’ anxiety about the trend. External managers with expertise in ESG investing, particularly renewable energy, could be a natural fit to help bridge this gap.

72% of respondents said they were somewhat or very interested in sustainable investing.

13% of respondents said they had received ESG suggestions from their advisors.

57% of investors who aren’t currently interested in ESG said they would change their minds if their advisors suggested it.

Takeaways

Over the 12 years that FlexShares has studied how advisors create efficiencies to grow their business, we've seen little change in the proportion of advisors who choose to outsource. But the outsourcing landscape is more dynamic than this persistent trend would suggest.

The most pronounced growth has been among those who already chose to outsource. These advisors have increased their use of external managers, and while a smaller proportion of RIAs take advantage of outsourced solutions, that subset is beginning to rely on third-party providers at a rapidly increasingly rate. This trend speaks to the increasing time constraints advisors face. As a result, those already comfortable with outsourcing have turned to this solution more frequently in order to better focus their limited time on what they do best.

Expectations in terms of the direct impact of outsourcing on revenue and performance might be another clue to this puzzle. Advisors who are already familiar with the benefits of outsourcing and have external manager contacts handy have been able to use this resource to pivot and flex during the instability of the pandemic. Communicating the value of outsourcing in these times and resetting expectations may increase the proportion of advisors who rely on third-party managers to give them the tools or freedom to intensify their focus on client relationships.

About This Survey

To conduct this year's survey – the seventh in a series examining advisor views on external investment management – FlexShares worked with Informa Engage and Wealthmanagement.com to field an electronic survey to more than 248 advisors and closely related professionals across the United States between January 10 and February 1, 2022. By the end of the survey period, 570 individual responses were received and included in the final report. The sponsor was not identified in the survey.