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Using portfolio compliance as a tool to demonstrate the value of advice to your clients

As we lament the challenges of dealing with both the increased regulatory burden of delivering advice and demonstrating the value of advice in a ‘fee for service’ world, is there an opportunity that wealth management firms are missing?

At Financial Simplicity, we believe that by taking a more client-centric and strategic compliance approach to portfolio management firms can simultaneously reduce the regulatory burden and business risk, while also providing opportunities to demonstrate dynamic client engagement and value-added opportunities.

Current transactional approach to compliance

At the heart of the solution is recognising that the compliance and advisory functions of the firm are often pulling in the opposite direction, by not sufficiently taking account of both individual clients' preferences or circumstances and the current state of investment markets.

To many, portfolio compliance is about ensuring that a professionally managed investment portfolio is consistent with the guideline regulations and specific servicing requirements of the client. Specifically, testing portfolios at the time of advice as to whether they fit within agreed asset allocation ranges using backward looking statistics,

acceptable in terms of possible portfolio downside (loss) movements versus long term portfolio returns.

This approach relies on generic statistical data and uses asset allocation as the primary measure of compliance for an investor portfolio. While there is merit in this asset allocation approach, the question is whether this is a sufficient enough measure given the reality that:

1. investors invest (and withdraw) at different times and rates, and
2. markets move up and down throughout this overall process.

This brings up questions of whether a portfolio that was compliant last week, is now compliant after a material market movement, and if not, what is the obligation for a professional adviser to know this and do something about it? Sounds like a material business risk to be managed as well as an opportunity to demonstrate value add to clients.

A strategic and client-centric approach

Portfolio compliance is not just about the theory of asset allocation. Specifically, if we agree that at each stage of a portfolio management process requires advice and adjustments that are in the best interests of each client, then we need the specific inputs and data for each client e.g., current capital gains tax positions, client specific preferences, rules and constraints to consider.

This approach throws up a number of data and operational challenges to apply an individualised approach in an efficient mass framework. If overcome, however, this can deliver clear client ‘value add’ and business benefits including:

- Extending portfolio compliance and asset allocation advice beyond the point of initial advice, to continual monitoring and adjustments made in the clients' best interests
- Resolving any conflicts that arise between the philosophy of asset allocation theory and what is deemed in the best interests of clients

- Ability to deliver and monitor a customised client-specific portfolio (with associated feel good) as opposed to a ‘one size fits many’ or a low value ‘set and forget’ client solution
- Moving compliance from a ‘general’ to ‘specific’ risk detection process for each client portfolio (covering more than just asset allocation), strengthening the firms ‘best interests’ obligations, fundamental regulatory (ASIC) compliance and reducing business risk
- With this ongoing monitoring and adjustment process comes ample opportunity to engage with the clients and demonstrate your value add

Sounds good in theory, how do you implement?

The challenge is to repack the fundamental portfolio modelling and compliance checking tools being used right now. More sophisticated technologies and data solutions allow you to:

1. enter rules, preferences and constraints that clients instruct
2. enter and adjust the asset allocations associated with each individual client
3. input and maintain model portfolios in all their permutations that client portfolios can reference

These three capabilities need to interact with each other not sequentially (with often human judgement required to resolve the differences), but simultaneously in a single, continuous, and repeatable process. Each check is critical in its own right. However, only when they are working interdependently and simultaneously can we achieve client-centric portfolio compliance checking.

What does best practice compliance and portfolio management look like?

Best practice compliance typically begins with fundamental compliance with ASIC licensee requirements; then you achieve transactional compliance through research and adherence to your firm’s recommended or approved investment lists. You can then achieve portfolio-based compliance with the use of model portfolios and broad asset allocation guidelines used as an overlay to the client’s portfolio. The Bull’s Eye for portfolio compliance is however when you achieve this at a client-specific level. You

score a portfolio management Bull's Eye when your process starts with setting your client's highly individual rules, preferences and constraints in advance of any other consideration.

This is the emergence of strategic compliance. If investment research is being applied in the specific interests of the individual client, not only is this something to keep the license holder or regulator happy, but it is also inherently good for each and every client. The quicker adjustments can be made (and tested for compliance) to individual portfolios consistent with robust research, the better it will be for the client and the firm. Strategic compliance approach can deliver a demonstrable, quantifiable and measurable improvement in client service and advice value add.

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