



# SHOULD YOU OUTSOURCE YOUR INVESTMENT MANAGEMENT?

By asking yourself three questions, you can quickly determine if you are a good candidate for outsourcing.

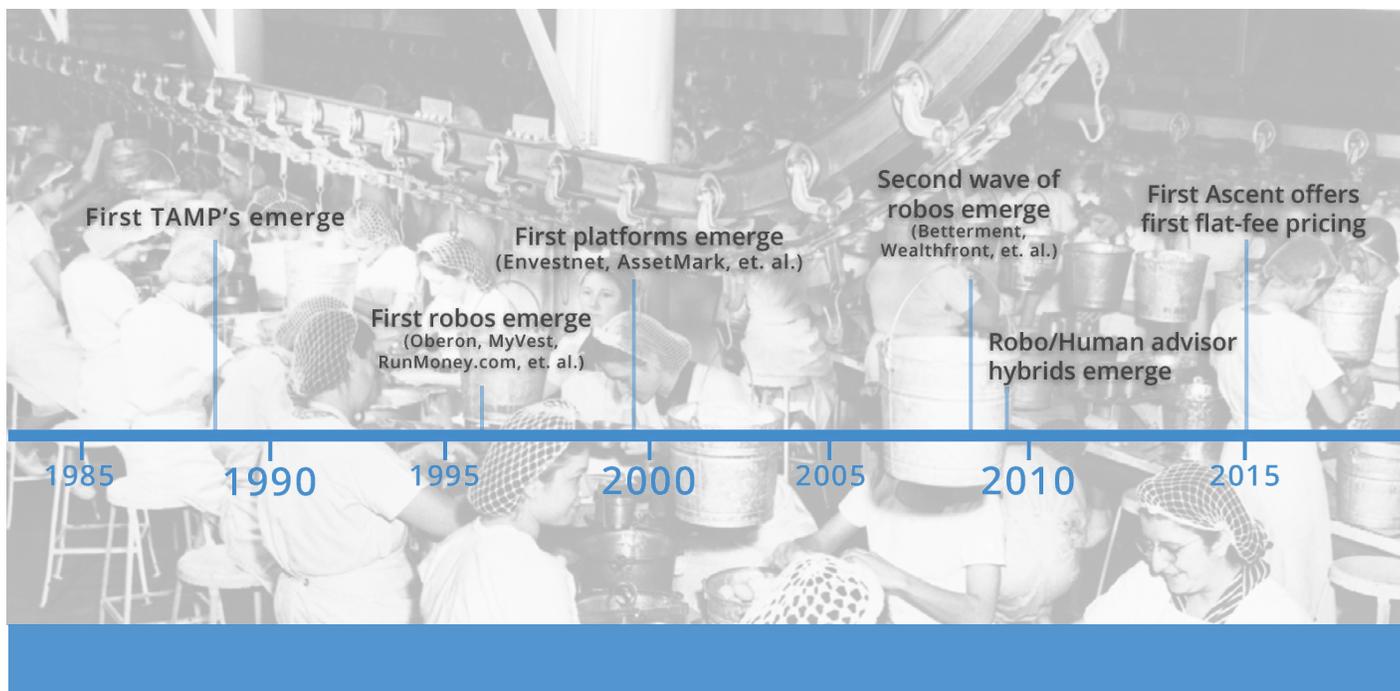
**Scott MacKillop**

*Founder and CEO,  
First Ascent Asset Management*

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**“ Understanding the benefits and the trade-offs will help you make the decision that is right for you and your practice.**

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## INDUSTRY TRENDS

Outsourcing of the investment management function by financial advisors has grown dramatically since its beginnings in the late 1980s. Turn-key asset management providers (TAMPs)—firms that offer outsourced portfolio management services to advisors—managed or administered over \$2 trillion by 2017, according to a study by Tiburon Strategic Advisors.

Clients also enjoy the benefits of outsourcing. A 2014 study by Northern Trust showed that clients have had an overwhelmingly positive response (92%) to outsourced investment management. This high level of acceptance has contributed to the continued growth and interest among advisors in outsourcing.

Regulatory pressures have also contributed to the trend toward outsourcing. New

regulations expanding fiduciary responsibilities to a broader set of advisors are causing an increased interest in outsourcing as advisors seek ways to delegate investment management responsibilities to specialists. Broker-dealers are also encouraging advisors to outsource to reduce potential investment-related liability.

Encouraging outsourcing is now a standard part of virtually every practice management seminar for advisors. It is positioned as a way to give advisors more time to attract and service clients while, at the same time, placing advisors and clients “on the same side of the table.”

## BY THE NUMBERS

92%

of clients had a positive reaction to outsourced investment management <sup>1</sup>

25-50%

of advisors outsource some or all of their investment management functions <sup>2</sup>

\$2.2T

in assets managed by TAMPs <sup>3</sup>

## THE GROWTH OF OUTSOURCING

The growth of outsourcing is directly attributable to its benefits to financial advisors. These include:

- improved portfolio quality
- relief from the burdens of account administration
- more time to focus on acquiring and servicing clients
- the ability to “institutionalize” the investment management function
- elimination of conflicts of interest
- cost reductions for firms and their clients

## HIGHLY PERSONAL DECISION

Despite its potential benefits, outsourcing is not for everyone. Depending on which studies you reference, somewhere between 25% to 50% of all advisors outsource some or all their investment management functions. That means many financial advisors continue to manage client assets themselves. That is because the advantages of outsourcing come with trade-offs.

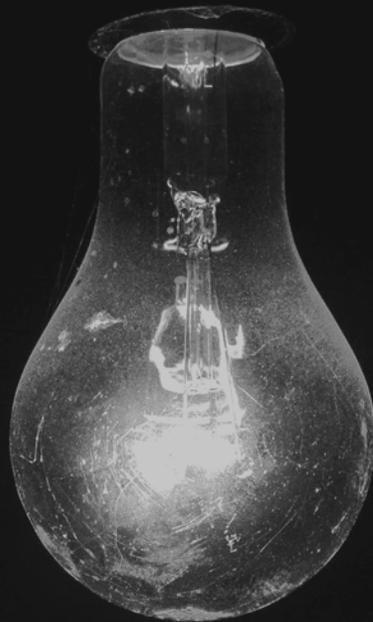
Understanding the benefits and trade-offs will help you make the decision that is right for you and your practice. By asking yourself three questions, you can quickly determine if you are a good candidate for outsourcing. Remember, the decision is a highly personal one that should be based on the facts and circumstances surrounding your business, not general industry trends.

<sup>1</sup>. <https://www.northerntrust.com/documents/white-papers/asset-management/2014-advisor-outsourcing-impacts-on-clients.pdf>

<sup>2-3</sup>. *Ramping up TAMPs for 2019 and Beyond*; wealthadvisor.com; Sept. 24, 2018

# 3 SIMPLE QUESTIONS

BY ASKING YOURSELF THREE QUESTIONS, YOU CAN QUICKLY DETERMINE IF YOU ARE A GOOD CANDIDATE FOR OUTSOURCING.



“

It is not the answer that enlightens, but the question.

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- Eugene Ionesco

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The first thing to consider is why you became a financial advisor in the first place.

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# 1 What's Your Passion?



Advisors usually fall into one of two camps. Either they love the technical aspects of the business or they love working with people.

If you're a "techie" whose passion is investing, you are probably not a good candidate for outsourcing. Why deprive yourself of the activity that brings you joy? However, if you're a techie whose passion is financial planning, outsourcing investment responsibilities could allow you to concentrate more on areas that truly delight you.

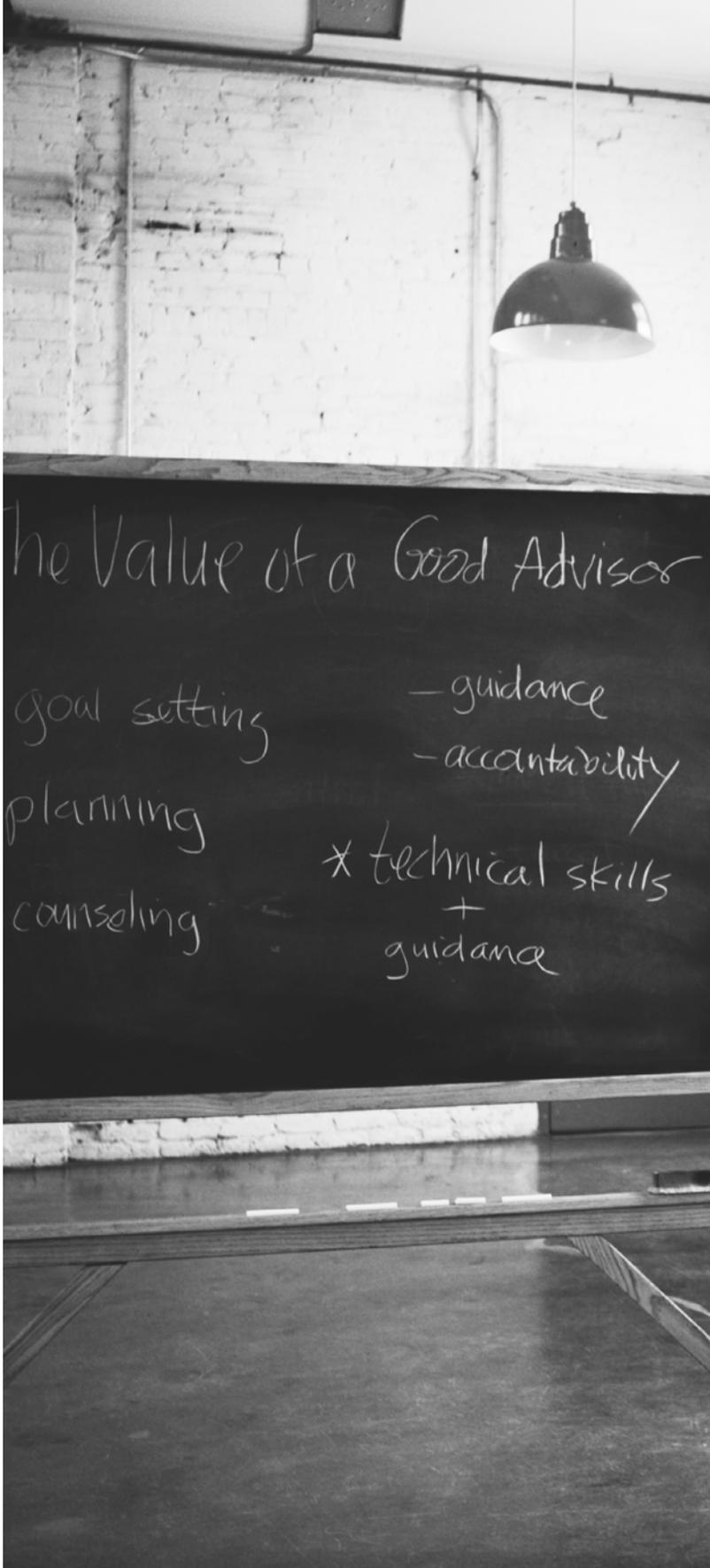
If you're a "people person," consider outsourcing. You could effectively buy back a significant number of hours each week and spend them interacting with clients and potential clients. This could energize you and enhance the quality of your work day.

# 2

## Where Do Your Talents Lie?

Even if you are passionate about investing, if you are not skilled at it, consider outsourcing. Your clients shouldn't suffer simply because you enjoy investing. You have a fiduciary duty to do what is in their best interests. Be honest in your self-assessment.

If you are good at investing, but don't care for it, pause before deciding to outsource. Make certain your outsourcing partner can serve your clients as well as you have.



The Value of a Good Advisor

- goal setting
- planning
- counseling
- guidance
- accountability
- \* technical skills + guidance

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Your decision should be based on your goals.

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### 3 What Are Your Goals?



If you are happy with your firm and your work life, you may not want to outsource.

The decision to outsource will change the nature of your practice and can be temporarily disruptive. These changes and disruptions can result in long-term benefits, but they should not be taken lightly. Outsource only if you are doing so to accomplish specific goals that you can clearly articulate.

Outsourcing can help you achieve a wide variety of possible goals. Many are discussed further under *Consider the Benefits*. You may have other specific goals that outsourcing can help with. Make sure you can articulate what you are trying to accomplish before you decide to outsource and that you have considered the factors discussed further under *But There Are Trade-Offs*.

# CONSIDER THE BENEFITS

If you think outsourcing may be right for you, here is a closer look at some of the benefits:

## MORE TIME TO GROW YOUR FIRM

Firms that outsource have more time to prospect for and service clients. This client-centric focus fosters new client acquisition and client retention. Advisors who spend time researching and implementing investment ideas do not have as much time to find and service clients.

It is certainly possible to build a thriving practice without outsourcing, but advisors who carve out more time to personally focus on growth and client service often see greater results than those who spend more time on technical investment issues.

“ Many studies have shown that financial advisors who outsource tend to have larger, more profitable firms than those who do not outsource.”<sup>4</sup>

4. <http://www.investmentnews.com/article/20161010/FREE/161019993/advisers-who-outsource-investment-management-make-more-money-than>

## ABILITY TO CONCENTRATE ON AREAS OF STRENGTH

Some advisory firms use outsourcing as a way of concentrating on their strengths and dispensing with investment activities where they add no special value. For example, some firms have strength in areas such as alternative investments or private equity, but have no special expertise in managing broadly diversified core portfolios. Others may

want to focus on managing their larger, more complex accounts to make sure they address their special needs. Such firms can selectively outsource investment management responsibilities to complement their areas of special focus or expertise.

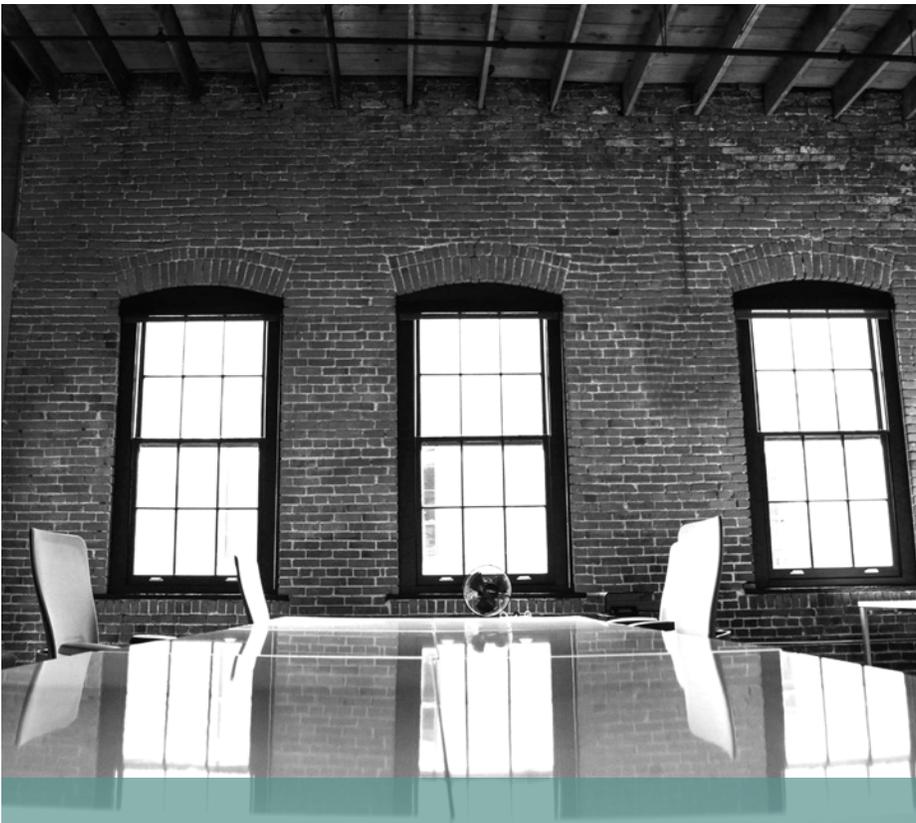
Still other firms may want to focus more of their resources on services that have a greater perceived value than asset

management. Services such as financial planning, tax and estate planning, and behavioral coaching offer firms the opportunity to address the individualized needs of their clients and provide more customized, high-value services. Outsourcing allows advisors to focus resources on these areas.

## ABILITY TO SIT ON THE SAME SIDE OF THE TABLE

Some financial advisory practices have concerns about the potential conflict of interest that exists when the firm creates a financial plan and then also implements the investment portion of that plan. The crux of the problem is that if the firm does a poor job of investing for the client, it is very hard for the advisor to “fire themselves” or provide an objective critique of their own investment performance.

Outsourcing can solve this problem. By outsourcing, an advisory firm can maintain an objective posture in analyzing and critiquing client investment performance. If the performance is not adequate (in whatever manner that may be measured), the advisor is free to terminate the outsourcing relationship while minimizing the impact on their own business.



## INVESTMENT DEPARTMENT

### COST SAVINGS

Running an in-house investment department can be expensive and time consuming. An investment department requires staffing, systems, and research tools that can drain a firm’s management and financial resources. Outsourcing can eliminate some or all of these expenses and distractions.

### CREDIBILITY

Some advisory firms do a fine job of investing but don’t have strong investment credentials on paper. This may hamper new client acquisition and weaken the firm’s competitive position. By outsourcing, a firm can enhance the credibility of its investment offering. The credibility and experience of the outsourcing partner become resources standing behind the advisory firm.

## OPERATIONAL EFFICIENCIES

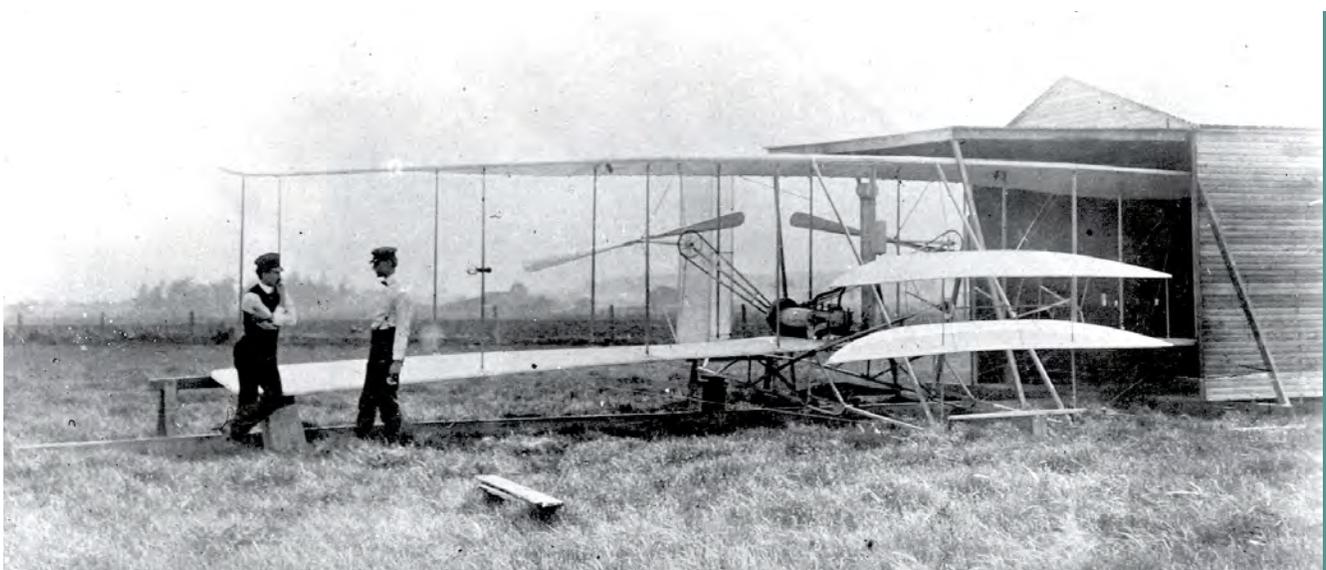
Maintaining a back office to support investment management activity can be expensive and time consuming. Firms that manage assets internally typically maintain portfolio accounting systems, performance reporting systems, billing systems, trading systems, and other systems associated with asset management. Then these systems must be maintained and operated by skilled staff.

Maintaining and operating a back office takes focus away from other areas where you can truly add value. Managing the staff, dealing with system upgrades and failures, and handling the headaches that come with running a back office take valuable time out of each day. Firms that outsource don't need back office systems or expend their valuable resources on them.

## INSTITUTIONALIZE A PRACTICE

Many advisory firms are dealing with succession planning issues. Others are dealing with the question of how to institutionalize their practice so it might be sold someday, allowing the advisor to realize the value of the firm they have worked so long and hard to build. In both cases, it can be difficult to transfer a practice to a new owner if the advisor who built the practice is the Chief Investment Officer.

By outsourcing, an advisor can, in effect, rent an investment department that can remain in place after the departure of the firm's founders. This enhances the transferability of the firm and improves the chances for a higher valuation.



## BUT THERE ARE TRADE-OFFS

Before you outsource, consider these factors as well as the benefits.

### COST

Outsourcing is not free and prices vary greatly among asset managers. In assessing the costs of outsourcing consider the manager's fee, the internal expenses of the portfolios, transactions costs and any other fees or expenses that may be charged for ancillary services.

Ask questions to avoid surprises.

Once you understand the total cost of doing business with the outsourcer, make sure to net any savings you achieve at your firm through outsourcing against the actual costs of outsourcing. This will give you the most accurate picture of the real cost.

### SERVICE

The quality of the ongoing service you receive will determine how satisfied you are with your outsourcing decision. Understand the service model and ask your outsourcing partner to walk you through basic procedures like

account opening and proposal generation. Get your staff involved so they can flag potential issues. Ask for referrals to other advisors who can share their experiences.

### CONTROL

When you outsource, you lose some control over the management of your clients' portfolios. When you are the manager, you can customize portfolios and respond to one-off requests, but there are limits on how much customization can be done

by outsourcing partners. They often have minimum account sizes, householding rules, and limits on services they provide. Make sure they are consistent with your needs.

“ While there are costs to consider, studies have shown that short-term costs are often offset by the ability to scale more quickly and service more clients over the long-term. ”

## PEOPLE

An outsourcing firm is no better than its people. Study their backgrounds, experience and reputations. Talk to as many of them as you can and visit their offices if possible. Make sure their culture, attitudes and work style are consistent with your own.

View outsourcing as you would any important long-term relationship. Make sure the people are competent, but also make sure that you like them and enjoy working with them. Look for people who have a positive, can-do attitude and genuinely care about your firm and your clients.

## FIT

It is important to make sure you are a good fit to work with any outsourcer you select. Learn about their target market, their average account size and their per-advisor AUM targets. Be sure they will value the relationship and not view you as a tag-along.

## PORTFOLIOS

Outsourcing firms come in all shapes and sizes. Make sure the portfolios of any outsourcing partners are consistent with your investment philosophy, and that they offer a range of portfolios to meet your needs. If they don't, you will need to use multiple outsourcing firms or continue to manage certain portfolios yourself.

Understand their investment process and how they achieved their performance. Discern between actual performance and any back-tested or hypothetical performance. Avoid doing business with firms that attempt to blur this distinction. Ask if their performance was prepared in accordance with the Global Investment Performance Standards (GIPS™).



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## CONCLUSION

Today there are hundreds of firms offering outsourced investment management services to financial advisors—it is a crowded and fragmented market. There are no dominant players.

The decision about whether outsourcing is right for your firm should be based on the needs, goals and preferences of your firm and the clients you serve.

Outsourcing is not for everyone. But with some soul-searching and a little detective work, you can determine if it is right for you and identify a partner that fits your needs, style, and investment philosophy.



“The bad news is time flies.  
The good news is that you’re the pilot.”

- Michael Altshuler

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First Ascent is a Registered Investment Advisor