AN INTERVIEW WITH MICHAEL HEBURN, PHILIP KESSLER, AND CAM GOODWIN

Charles Schwab Panel—Automated Advice

One of the growing trends over the past several years has been the proliferation of automated advice platforms (i.e., robo-advice). Investments & Wealth Monitor (IWM) *wanted to understand this phenomenon from a user perspective. The edited interview presented below was conducted at the 2016 Schwab IMPACT Conference in October 2016. Questions were asked of representatives from three firms that have embraced a digital-advice platform: Michael Heburn, chief operating officer of Level Financial Advisors; Philip Kessler, JD, managing partner of SWS Partners; and Cam Goodwin, CFP®, CPFA, chief operating officer of HawsGoodwin.*

IWM: There has been a lot of attention on the various automated advice offerings. How did you evaluate the offerings and what was the motivation behind pursuing an automated investment management platform?

Heburn: When we first looked at it, we thought it was an opportunity for us to reach a client base that we didn't traditionally reach. We had a stated minimum of $250,000 in assets under management, and we said, "This is a great chance for us to reach a group of people that aren't there yet."

We thought that investment management was becoming more and more commoditized. We were trying to leverage financial planning and determine the next generation of tools. To sub-brand it, we call it Blueprint. We created our own brand and said, "We're going to reach out to a very specific target audience and see if we can generate some excitement about it."

Goodwin: We came from a large wirehouse, and so traditionally we had always focused on high-net-worth investors. We always knew in the back of our minds that there's a large segment of clients out there that is really underserved. We've always wanted to find a way to serve those clients.

We call them the "emerging investor" internally. It is how we refer to everybody on ProsperHG, basically. But it's that level that's not yet ready for our wealth management side, but we want to develop relationships with them now. So we were excited this technology really came about, and it has allowed us to target and go after that client segment.

Kessler: My partner and I, as we were thinking about putting together our partnership, looked at automated investing as where the industry is going, as in: "We don't have a choice. You're either going to integrate this or you're going to get left behind."

So we looked at it and said, "It has to be a large component part of the firm." We do some client segmentation, but we use automated advice for anything under $2 million, and then we layer on the financial planning. That's a retainer. You're paying a yearly retainer to have access to the financial planning. Just a little different approach.

IWM: What other services are part of your offering?

Goodwin: Every client that comes onto ProsperHG, number one, they get full access to a Certified Financial Planner™ professional, just like a regular advisor. They also get a financial plan from day one. Our goal is to help get them on a plan and help them save. Our goal with every ProsperHG client is to eventually get them to our wealth management side. So we start with that financial plan, to get them on track to build wealth. Then we have a specific service model ongoing with these clients where we will call them typically over the phone and do two reviews with them annually.

We've priced at 50 basis points, which is pretty low. We feel like if we do our job and do it well, we'll be able to be profitable at that level. Our traditional offering starts at 1 percent and tiers down from there.

Heburn: Blueprint is one of three segments. It's our entry-level segment for investors. We're offering a base financial plan. One of the things that's unique about the way we do it is we don't let clients sign themselves up on the platform. We require them to meet with an advisor. We give every client a dedicated advisor, and we make sure that they come in and meet with us and talk about what they're trying to accomplish.

We offer unlimited e-mail and phone calls with the dedicated advisor. They can use Citrix or GoToMeeting, too. We charge 1 percent of assets under management, which is the same fee that we charge for all tiers. Our approach to it is that as your assets grow and your life becomes more complicated and your financial needs become more complicated, you graduate to a higher level of service for the same price. That's how we sell it to our clients, and it seems to be speaking to them.

Kessler: Our firm's construct is a little different in that we don't use any funds. We either have exchange-traded funds (ETFs) or individual shares of stock. So when we look at a private client, typically we're utilizing individual stock portfolios. We'll go out and curate private equity and real estate deals.

Originally we priced it at 50 basis points. Then we came to the conclusion that we wanted it to be the same integration with the firm no matter what platform you were on, whether it was financial planning or whether it was service or whether it was access to anything else that we do to just have no difference, no matter whether you were on what we call SWS Direct or whether you were a private client. So same service team, same financial planning team.

We actually raised the fee to 75 basis points for two reasons: one, because we were putting forth our service team, but two, we looked at the marketplace and realized that the independents, whether that's Betterment or Wealthfront, had created a race to the bottom. They were commoditizing a commodity, and we just didn't want to be there. We wanted to make sure that people understood that they were getting more sophisticated and needed direct access to a human being. So we raised the fee.

IWM: It sounds like the automated offering is a new business model for each of you. Did any of you think about going 100-percent digital when you were thinking through this?

Heburn: We didn't. Of course we talked about it, but we thought for us, getting people into this platform accomplishes a couple of really neat things. One, we think it's cultivating future investors for our larger platform, and to be able to get people in there and establish a relationship is key because you can put anybody into an automated platform and they could never speak to anybody at your firm. But if they have a dedicated advisor and they're having conversations with that person over the years and they begin to trust that person, we think it's more likely that they're going to want to stay in the future.

The other part that we think is interesting is that for our younger advisors in the office, our less-tenured advisors and CFP® professionals, this gives them an opportunity to work their craft a little bit on a less-complex client in the beginning and establish relationships and learn how to cultivate business. These may be opportunities they wouldn't necessarily have if we were starting them out with our more traditional clients with $500,000 in assets under management. We think that interaction is benefiting both the clients and of course the career development of our employees.

Goodwin: I would echo that. We're very similar from that standpoint. From day one we want to know our clients. We don't want to roll out a completely digital offering because we think that what sets us apart is that service model, the access to a Certified Financial Planner professional. We want to know those clients. We want to know their families.

We want to know when they get job promotions and good things happen in their lives so we can help advise them along the way because, again, our endgame with these clients is to help them grow their wealth and get them to our wealth management side. So we never want to be a pure robot, so to speak. We always want to have that personal touch.

Kessler: We're probably a little different in that it's really up to the client. One of the unique things that's come out of utilizing this technology is you get to look at your client a little differently. We have clients that call us all the time, and we have some clients that will never call us again. That's okay. It's completely up to them.

The technology is—I think the word I would use is empowering. When you can see what you own, what you make, what you pay 24/7, then we joke about brokers. Why do you need to come and meet with me quarterly? I'm going to show you a report you can see instantly on your phone any time you want. So you're going to deal with us on the things that are really important.

We found that the communications we've gotten back from clients are about the things that we want to communicate with them about. For example, when the Brexit happened, the phone didn't ring, because you can go on your phone. You can click it. You realize that the guy screaming at you on CNBC is out of his mind and your portfolio is okay, and you go on about your day. It's been interesting for us just to watch how that works. It's allowed clients to interact with us how they want to interact with us.

IWM: There is an impression that the automated offering is designed to attract smaller clients and millennials. Who are you attracting with this new offering—millennial tech-savvy investors, etc.?

Goodwin: When we first launched ProsperHG, we had that client in mind. We were targeting the millennials, mid-20s, late 20s, and we quickly realized that that was really too young. They didn't need us yet. They needed financial planning help. They needed some advice about getting out of debt, student loans, those sorts of things. But they didn't necessarily have a nest egg. They didn't need an investment manager at this point.

Our average client age is about 38 years old on ProsperHG. So the demographic is much older than we thought. We kind of had to backtrack and change our marketing strategy to target that client base. Our clients are typically young families that are just starting to save and young professionals who are in a pretty high income. They could potentially be good clients for our wealth management side in five to 10 years.

Heburn: I think it's similar. We've had mostly young professionals, for sure. Our target when we set out was 28 to 38, high earning potential but not a lot saved away already, professional definitely, people who have the ability to acquire wealth over a period of years. We're finding for the most part that's what we're getting even without a really targeted marketing campaign to date.

Most of the work we've done with our Blueprint has been social media, Google searches, things like that. We haven't even set out really to do a targeted campaign. When we do, it'll be interesting to see what comes knocking on the door. But our target is definitely that high-earning-potential candidate. I hate to use the word "millennial" because it means so many different things, but they're in there.

Kessler: So as we think about how we go to market in general as a firm, it's around fees. If you talk to somebody who is coming out of a brokerage experience where they're paying 125 bps to their financial advisor and then they're putting another 85 bps into their 15-mutual-fund portfolio, and then their 12b-1 fee, at some point they're cruising close to 2.5 percent.

The outcome, whether you're a young person looking to save money or you're someone who's heading into retirement—a former law professor of mine called me yesterday, and we're going to put her on there. It's a $2.5-million account. The reason being is that her chance of success goes up exponentially if her fees drop from 2.5 percent to 75 basis points, because I don't think they're raising interest rates any time soon.

IWM: We're curious if this new offering has cannibalized your existing business. How have your existing clients reacted to the new offering?

Goodwin: This is probably the number-one question we get from advisors who are looking to implement an automated platform like this. We have decided to just embrace it, and so we have told our existing client base about ProsperHG. We wanted them to know about it. We're excited about it.

If we did have a client who wanted to move from the wealth management side over to ProsperHG, we would let them do that as long as they're okay with the reduced service level that goes along with it. Most of our wealth management clients understand, number one, that there's some level of sophistication that goes along with their portfolios. We spend time with their CPAs and attorneys to help develop plans for them, and that goes away. ProsperHG doesn't give that high a service level. To date we haven't had any do that, again, but if they wanted to do that we'd be happy to let them do it.

Kessler: Really, we haven't had any pushback or any question. We were a little targeted in how we did what we did. We have a fee schedule for clients under $2 million. If you want to be a private client, it's 125 basis points. The minute you explain to them 50 basis points over time, they get it.

But to me, it's a little different. We've seen a large uptake. They like the technology and they like the access. So cannibalization maybe, but our fee structure is 75 basis points for accounts $5 million and up. Now we're 75 basis points for direct. We actually built the business model around being able to be profitable with the understanding that the fees we charge will go down over time, not up. So we built that into the business model for the firm.

Heburn: As you might expect, we don't have any cannibalization keeping the price the same. We haven't had a lot of pushback from people saying: "Well, wait a minute. You're charging me 1 percent, and I'm getting this small amount of service." It's really been us telling people, "You're going to graduate to a higher level of service and get more services and more action from us as your assets grow." I think that's a positive message for people. It gives them something to aspire to.

For us, it's been positive. We also have a break. Once you get beyond $750,000 assets under management, our normal price fee actually creates a break for high-net-worth clients.

IWM: It seems like part of your motivation for offering automated advice has been to grow your business. How do you position this in the marketplace? How do you brand it?

Goodwin: We actually engaged an outside marketing firm to help us create that brand. We knew we wanted a separate brand from the start, but we did want to in some way connect it back to our HawsGoodwin brand to help make that transition once they become eligible for our wealth management platform. We think that name really encompasses what our clients want. They want to prosper, and it seemed to resonate well with our clients. Adding the HG to the end of it connects them to our firm from day one.

Heburn: We hired an outside marketing agency, too, and we ran the full gamut. We did qualitative research. Our firm name was originally Schroeder, Braxton, and Vogt, the three partners with the firm at the time, and we decided we wanted to create something that spoke to what we did and also spoke to this whole idea of trying to get people to reach a higher level of financial freedom or reach their goals.

Then when we engaged the marketing firm, we started talking about our different segments and our different tiers. Blueprint, being the entry-level tier, you're drawing things out and trying to figure out what's going to be going on in the future. Then you move into Foundation, a metaphor for setting the groundwork, the foundation, for your financial home or castle someday maybe. Then we move to Cornerstone, which is our top tier for folks who have the highest amount of assets under management and have the most complicated needs.

We used all those different names and built the imagery and the logo around it. So when you see Blueprint, Foundation, and Cornerstone, you see our little arrows that are in our normal name, and everything has a consistent look and feel. It was part of a broader marketing arrangement.

Kessler: So far it's all been organic marketing just through networks no different than we would communicate anything else about the firm, although we are in the process of trying to figure out what that will look like. There will be some sort of online presence, and it'll be related to everything that we're going to be doing firm-wide.

It's interesting. We're not marketers, and we haven't spent any money on marketing, as you may tell from our logo. But we named it SWS Direct because when we first started into it, we thought it was going to be this separate animal for smaller clients, and we learned later that it wasn't. I wouldn't be surprised if we don't drop the name, that it just is part of what we do and how we do it.

Heburn: We hired the marketing agency. We spent most of the beginning of 2016 making the name change. We redid the website and set all that up. We've done a lot of work with SEO (search engine optimization) and trying to get our online presence to show up at the beginning of searches, Google and Bing and different places. We've done some general marketing and advertising for our firm on public radio in different places. But we haven't done anything direct yet for Blueprint. Our plans for 2017 will incorporate a portion of our marketing budget to go toward this segment, targeting a very specific group of people we're trying to reach with this platform.

One of the big changes for us in our strategic plan was having a marketing budget and really sitting down and saying: "Who are we trying to reach? How much are we going to spend?" We do it as a percentage of revenue and then look at it four, five, six years down the line and say, "Okay, if we're spending 3 percent of revenue, maybe it's 6 or 7 percent six or seven years from now."

How much of that bucket are we going to spend on Blueprint versus Cornerstone? Obviously Cornerstone is our bread and butter, our largest tier, so we're going to spend a much higher percentage of our marketing budget on something like that than we would on Blueprint. With Blueprint, we have to engage an entirely different type of audience and go digital and do a lot on the Internet to really make it work for us.

Goodwin: We launched ProsperHG a little over a year ago, and it's kind of been in soft launch mode for a while just to see how it goes. Up to this date, we've done pretty much organic growth. We did roll out earlier this year from a marketing perspective. One avenue we're exploring is through a division of HawsGoodwin Financial that does corporate retirement plans. We have gone to those companies and begun to market ProsperHG for them to roll out to their employees. We've had some early success with that, some early adoption from those companies to use ProsperHG with their clients for their assets that are outside the 401(k) plan we're managing for them.

And then we've been working on a big social media strategy campaign. So I'll be able to report a little bit more about how successful we are with that, but we are going to start targeting more of our demographic. Now that we really know what that demographic is, we can get really targeted on social media and reach the masses in that way.

***IWM*:** Many advisors are looking toward automated investment management as a means to scale their businesses or get efficiency. Has that been your experience to date? Are there operational efficiencies?

Kessler: In fact, that's one of the key reasons we incorporated it in the firm. To be frank, we look at it as leverage not only for the clients. They obviously are going to get a better outcome because it's less expensive. But speaking as the owner of the firm, there are a lot less people I have to hire. This thing never takes a vacation. It doesn't need benefits.

I get it, but the point is that if you think about it from the ability to scale the firm, and the way that we're constructed, just so you understand, is that all the clients are clients of the firm. There are no individual books of business. Then we've built the team around a specialty, whether that's service or whether that's financial planning or whether that's client development. If you're in one of those buckets, that's what you do, and that's all we ask of you.

When I went wheels up Monday, we had 199 accounts. We'll probably have 210 by next Monday. We figure we can probably triple the size of it by this time next year. For us, it has been a really strong growth leverage from the firm side.

Heburn: Undoubtedly it really is a way to build operational efficiency into your practice. The way we look at it it's freeing up the time for our professionals to do more value-added types of things. We do believe that the investment management side of things is becoming more and more commoditized, and I would venture to guess that somewhere down the line a vast majority of our clients will be in some form of semi-automatic rebalancing of some kind.

So we look at it as a way to build for the future. We think our professionals enjoy having the ability to have a relationship with a client where you don't have to spend most of your time doing that type of activity. Then when they call, you're ready to just answer their questions and help them.

We do it a little differently, too. Our research showed us that the people who are in this platform prefer to take smaller bites of the apple. We actually do a monthly billing on this platform, and so that's probably the biggest operational change we had when we implemented it. We've spent a lot of time focusing on cleaning up that process to make it quick and easy. We spend five, ten minutes billing our accounts once a month, and it's been popular.

It's looked at almost like a subscription-based type of offering by our clients. But undoubtedly as it matures and as it becomes more robust, it is going to be a game-changer for advisory firms that are looking to grow because you can grow without adding headcount. That's going to be critical in our business in the future.

Goodwin: I wish the rest of our business was as efficient as this. But it is very efficient. We spend most of our time on the onboarding process because we do a financial plan. So we'll spend a couple hours with the client, but once we have that client onboarded—it's a completely paperless onboarding, which is really nice. Really just our time that goes into the front-end planning piece. That is the biggest thing that we deal with operationally. But we think that's very profitable operationally to work with those clients.

Heburn: Just to add one thing, too, when we talk to our employees about this type of system, of course people who are in the jobs where they're supposed to be doing this type of work and now you've replaced it with something automatic, they can get a little antsy. What we've done is we've said: "Listen, this is going to allow us to grow. This is good for the future." Not only are we going to have to do this to compete in the future anyways because our contemporaries are going to do this whether we like it or not, but it really does give them the freedom to do so many other things that they wouldn't be able to do if they had the weight of 200 clients on them in this platform and they had to do everything manually. The reporting alone I think is also just a flat-out money-saver when it comes to postage and printing and copiers and all these other hard things that you have to do if you're sending out reports. So that in and of itself is a huge saver.

IWM: Culturally, what was the reaction from your employees? Did they get on board immediately or did it take a little coaxing?

Heburn: It's about establishing trust. When I started with the firm and we didn't even have this, there was some just kind of like, "Okay, they just hired this person to run the business, and what's that going to be like?" But I think in any process where you have change of something like this, it's about buy-in.

It's about getting people in in the beginning and talking about what you're trying to do and get their ideas, because once you get the buy-in, people will understand the value. Then they will pull on the rope with you and you can get things done. But if you just come in and say, "This is what we're doing tomorrow," or if you start laying people off or something like that, you're really going to have a hard sell when it comes to the employees, for sure.

Goodwin: Our employees were excited about it from day one. They knew this was something that our client segment, like I said earlier, that we always wanted to serve, number one, they did, too. So when we were able to roll this out, everybody was on board and bought in from day one.

Kessler: It's a little different, obviously, because we've started this way. So everyone that's at the firm grew up with it effectively. But I think it's been great because again, if I look at it from a hiring standpoint, which is probably more appropriate, I just hired a young guy who fell out of the back of Morgan Stanley. He was like, "All I want to do is financial planning."

"Perfect, that's all I want you to do." If you think about how you hire and think about how you want to construct your firm, I think it offers you the ability to be more strategic in your hiring. This guy couldn't client-develop out of a wet paper bag, but he's really good in front of clients. He's really good. He's forgotten more about estate planning/financial planning than I'll ever know, but he was not going to be a sales guy. He's never going to build a book of business, nor does he want to, which is fine.

I think it does give you an opportunity to be more strategic and more tactical in your hiring going forward because you can offer people a much more detailed understanding of what they're doing and set expectations appropriately that way.

IWM: How do you balance between the scale of the technology and the need for human interaction? How do your clients react to the idea of having a time limit that they can speak to you?

Heburn: We do have a stated time limit. I think it's more of a "don't ask, don't tell, don't pursue" policy. We've never had to enforce it. I think we leave it up to the individual judgment of the advisors who are dealing with these clients. I don't see any evidence in our firm yet of people abusing it. We know it'll probably happen someday.

It's very soft right now. Eventually we're going to have to probably put something in place, but we leave it up to the individual advisor, because if they've got a great client who they think is going to be great for them in the future and if they want to spend a little more time cultivating that relationship, we're probably not going to stand in the way of that.

IWM: How you go about choosing which ETFs go into each strategy? How do you develop your asset allocation models?

Goodwin: We have an investment committee that meets every week. Our ProsperHG clients, the portfolios we manage on that platform, actually mirror the asset allocation of our wealth management clients' strategies. So when we make a change on this side, we'll tweak it on this side. As far as evaluating the ETFs, that's what we do on an ongoing basis. We try to find the best possible option to meet those clients' goals in each asset category, and we do that through our regular investment committee meetings and review all those on an ongoing basis.

Kessler: Our chief investment officer handles most of that analysis, and then we sit down and say: "Okay, what makes the most sense?" It really comes down to how you're constructed and how you build your portfolios. I don't know that the process would be any different.

IWM: Thank you for sharing your experiences. This addresses many of the questions and concerns raised about automated advice. It sounds like it has met your expectations, and allowed you to grow and scale your respective businesses.