The TAILORED FIT:

How Advisors Can Use Technology to Mass-Customize Financial Planning

By Joe Elsasser, CFP®, president of Covisum®

ABSTRACT

Technology in the financial services industry falls short.

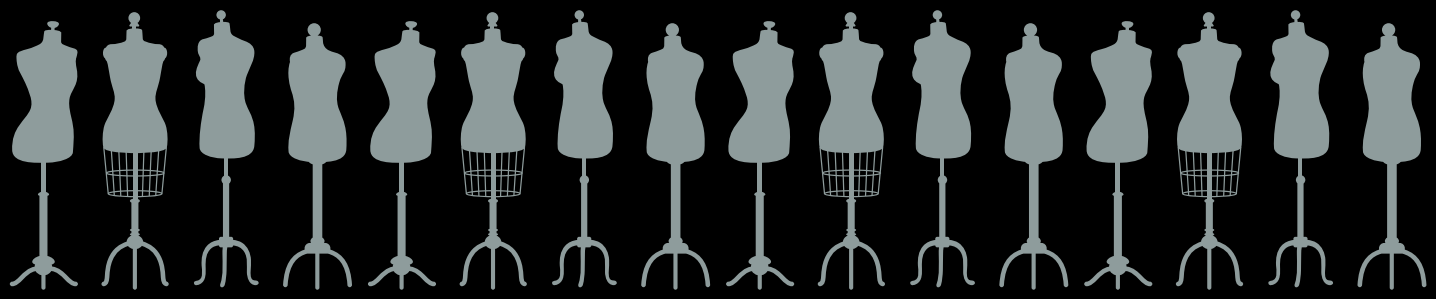
In spite of the huge industry push for "open architecture," fintech has not innovated the types of solutions that advisors in an evolving industry need in order to sustain their practices. Today's tech tools don't integrate deeply enough with each other to show how a decision in one engine impacts the decision in a different engine. This inadequacy leaves advisors to manually calculate these complicated interactions — a nearly impossible task for time-strapped advisors who need to serve multiple clients to make a profit in the current business model. A growing financial practice simply cannot sustain fully customizing each aspect of an individual's retirement strategy one component at a time.

But making decisions in a vacuum is not an option either. Ignoring the implications of one decision on the other results in advisors failing to meet their fiduciary and regulatory obligations.

The future of the financial services industry depends on technological innovations that will solve these challenges. Financial tech companies must provide the tools for mass-customization, and advisors who utilize these innovations will be positioned to serve the mass-affluent, using their unique skills and expert knowledge to finetune, or tailor, each client's financial plan.

MASS-CUSTOMIZATION:

a marketing and manufacturing technique that combines the flexibility and personalization of custom-made products with the low unit costs associated with mass production[1].



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[1] https://www.investopedia.com/terms/m/masscustomization.asp

THE BESPOKE SUIT

A bespoke suit is made completely from scratch, designed specifically for a single wearer. This process includes up to 50 individual measurements, assessing the wearer's posture, and selecting the right fabrics, linings and details. Small details about the wearer's lifestyle are also considered. Is the individual likely to hold loose change, a cigar or an iPhone in the suit pockets? After these decisions are made, the fabric is cut and loosely sewn together.

Next, it's time for the first fitting. The tailor makes modifications and customizations based on this first fitting, followed by second and third fittings to refine the final garment. A true bespoke suit is likely to cost upwards of $5,000 and will be made by a team of highly skilled tailors over a period of eight to 10 weeks.

The vast majority of men's suits worn today fall into a category known as "ready to wear." You go to a clothing store, pick a suit off the rack, have a tailor make a few adjustments, and it's likely to be a reasonably good fit at a dramatically lower price point.

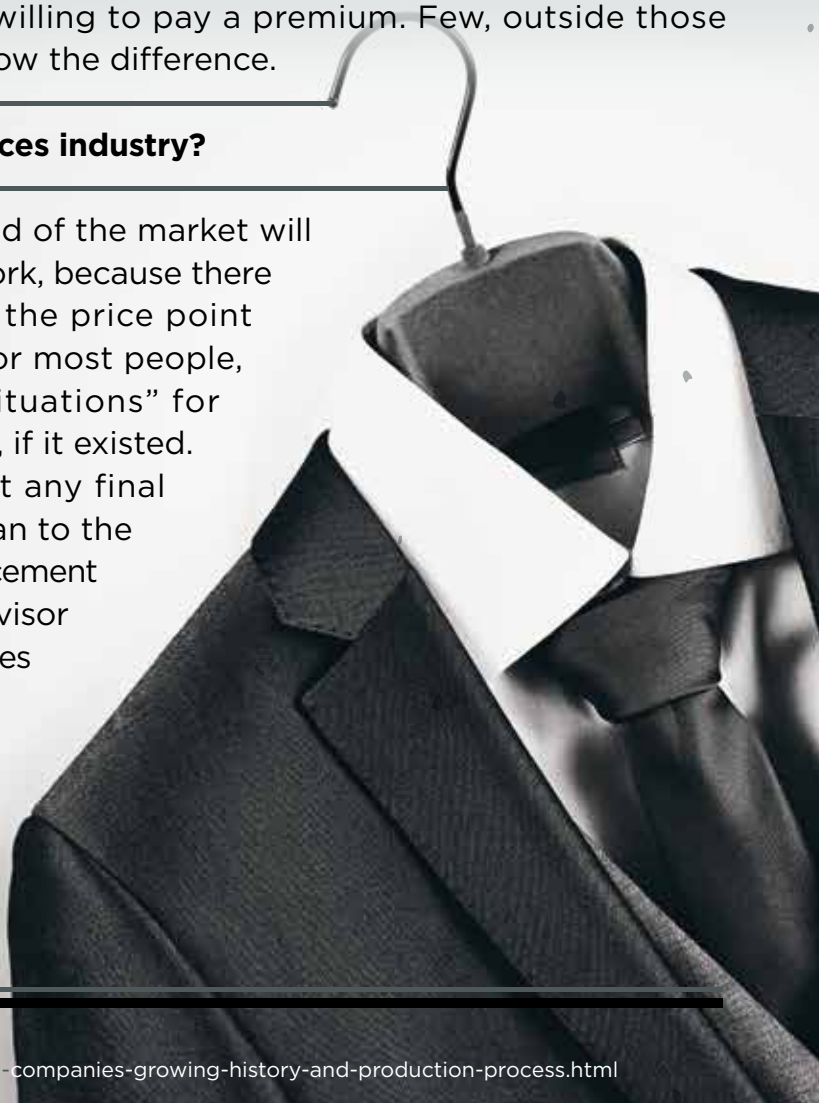
READY TO WEAR

Before ready-to-wear suits were a mainstream commodity, each element of the suit-making process was its own trade. Spinsters spun wool into thread, weavers weaved thread into fabric and tailors made fabric into clothing. Each of these trades or professions was, for the most part, displaced by technology. The invention and use of the water frame in the late 1760s[2] effectively industrialized the manufacture of thread. The professionals who oversee the development, design, and ultimately, the machines that manufacture thread are now called "seam engineers[3]." The power loom partially mechanized the weaving of cloth, and finally, the weaving of thread into fabric became automated. The commercial sewing machine enabled a much lower-skilled employee to create clothing of reasonable quality at a much lower cost. Textile engineers oversee this process. The automation, machination and commercialization of each step, from the manufacture of thread to fabric and finished clothing displaced huge numbers of semi-skilled laborers and replaced them with highly skilled professionals who oversee the machines and their output.

Yet, despite all of the technological advances and industrialization in the clothing industry, the high-end bespoke suit remains. People who buy bespoke suits buy them for the exceptional construction and individualized fit and are willing to pay a premium. Few, outside those who choose to wear bespoke suits, would know the difference.

Can you see the parallel to the financial services industry?

In the financial services world, the highest end of the market will always need fully custom financial planning work, because there are enough unique circumstances to make the price point tenable and yet still valuable to the client. For most people, however, there are a number of "normal situations" for which a calculation engine could do the work, if it existed. The financial planner could then implement any final tweaks that truly personalize the financial plan to the client's situation. Like the tailor, there is no replacement for the special touch and expertise that the advisor can bring to the service. But the greater efficiencies of the mass-customization process make the service of highly customized, quality advice more affordable to the mass-affluent, while still adding value for which the consumer is willing to pay.



[2]https://www.britannica.com/biography/Richard-Arkwright
[3]http://www.goldnfiber.com/2013/04/leading-thread-manufacturing-companies-growing-history-and-production-process.html

THRIVING THROUGH CHANGING TIMES

But who is willing to pay for this specific, mass-customized service? And who will successfully serve this niche?

To understand how this applies to financial services, another garment industry comparison serves as a great parallel.

You've likely heard the Men's Wearhouse slogan: "You're going to love the way you look, I guarantee it." Men's Wearhouse carved out a niche and grew to a multi-billion dollar business in the face of even further commoditization of the industry. Men's Wearhouse did a few things remarkably right.

First, it chose a very specific niche — mass-affluent men.

Second, it defined how it would serve that niche better than anyone else — through a high level of service and by treating their employees extremely well. Men's Wearhouse offers in-depth training and attractive compensation. It also offers customization (by vertical integration of in-store tailors), ease of in-and-out the door and reasonable pricing without the need to wait for sales.

Finally, to attract their targeted customers, they focused their message on the emotional outcome of wearing their products — you'll feel good about how you look[4] — and communicated that message via TV and radio.

Men's Wearhouse didn't create the technology or the distribution models that allowed it to thrive. Rather, it capitalized on the convergence of several trends. The evolution of the ready-to-wear clothing industry, from manufacturing through distribution, could not have happened without the invention of the water frame, the power loom or the sewing machine. These machines made processes much more readily available and less expensive, which in turn made the finished product considerably less expensive. Reasonably high quality and well-fitting garments could be delivered at a cost that allows people to have closets full of clothes. Standardization of sizing and new marketing mediums, including widespread availability of radio and TV, increased the ability to market granularly to a specific customer.

Men's Wearhouse identified a niche market and created its own mass-customized business to serve it. By creating real value for everyone — their customers, employees and shareholders — they found success.

[4] http://www.workforce.com/2000/07/01/the-mens-wearhouse-growth-in-a-declining-market/

THE FUTURE IS VERTICAL INTEGRATION

One reason the Men's Wearhouse approach was so successful was its use of vertical integration.

In simplest form, vertical integration occurs when a company controls one or more stages of its supply chain. For example, if a manufacturing company were to open a direct marketing division, bypassing third-party retail distribution, it would be employing the strategy of vertical integration. Or another example would be a retailer buying one or more of its suppliers in order to make its own products.

Vertical integration can benefit a company by:

- Creating economies of scale
- Enabling a firm to deliver a differentiated experience by providing exclusive products
- Offering pricing that is not available through competitive firms

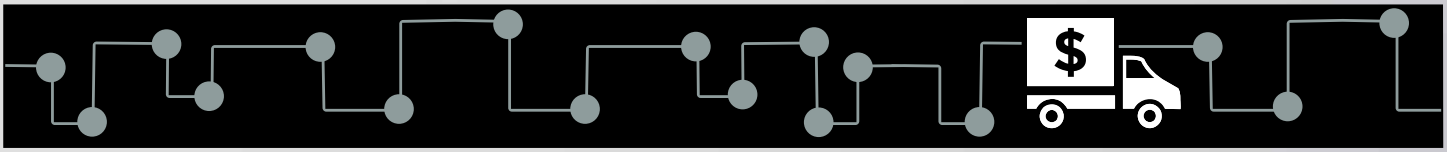
While the financial services industry has its own examples of companies with vertical integration, the most successful vertically integrated firms, to date, have been those that unite product with distribution — for example, insurance companies with captive insurance agents or investment banks that open retail broker-dealers.

The goal of the financial services industry, historically, has been product distribution. Whether the product was insurance, investments, loans or savings vehicles, the sales agent was primarily a distributor of product. For the vertically integrated financial services organization, the sales agent had the advantage of products being exclusively available to him, making his "advice" critical to the product distribution process.

The financial services industry, however, is undergoing one of its most dramatic changes — moving away from product-focused sales and toward a service-based approach where advice is the deliverable to the consumer. In this world, vertical integration takes on an entirely different look. It is no longer simply an insurance company with captive agents. **Financial decision manufacturers become the critical input.**

To date, the industry's advice services primarily have been reserved to the specialist professional — a CPA, an attorney, a CFP®, or a life insurance professional with specific business planning expertise. In recent years, the range of advice has broadened, fueled by consumer demand and innovative financial planning and technology firms. Also behind the momentum are various fiduciary initiatives, most recently the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Department of Labor's fiduciary rule, the Securities and Exchange Commission's best interest proposed rules, and even state laws surrounding fiduciary insurance sales. Consumers can now find help with decisions such as when to claim Social Security and which assets to use to create retirement income. And advisors who embrace the advice-first model achieve much higher response rates to their marketing than more traditional approaches[5].

In a business model where information and expertise are the products, the need for technology soars. Financial services professionals must have processes and systems in place to aid the speed of service so the business is sustainable. Software development and other innovations help financial services professionals quickly identify ideal financial scenarios. In this way, the laborious manual calculations and other work are systematized.



[5]https://www.kitces.com/blog/how-all-financial-planning-even-fiduciary-is-about-sales-sales-sales/

As these decisions become more and more effectively systematized through software development and innovation, the primary skill of retail advice distributors will be to relate the decision engine to the end client and help the client identify and overcome any emotional biases against the most appropriate and personally tailored decisions. As a result, the vertically integrated firm of the future makes heavy investments into ensuring that the decision engines their firm uses are the best at delivering the right answers for their specific clientele[6]. These vertically integrated firms will ensure that their advisors are well-equipped to understand the behavioral challenges that all humans face and coach their clients to overcome biases in order to make better decisions.

THE VERTICALLY INTEGRATED FIRM OF THE FUTURE INVESTS IN DECISION ENGINES THAT EXCEL AT DELIVERING THE RIGHT ANSWERS FOR THEIR SPECIFIC CLIENTELE.

The product-distribution advice model and the financial-advice model are not philosophically incompatible. Financial advice also includes helping clients select the right product to serve their needs. But because the universe of products is so broad, the advice model tends to only look at bigger decisions, such as which accounts to contribute to or draw from or how much to save versus how much to spend. This is where defining a niche can help the financial planning professional narrow the universe, calculate and systematize certain decisions that apply in many of those situations using available technology, and create a business model in which the value provided — whether it's product- or service-centric, or a hybrid of both — sustains the business.

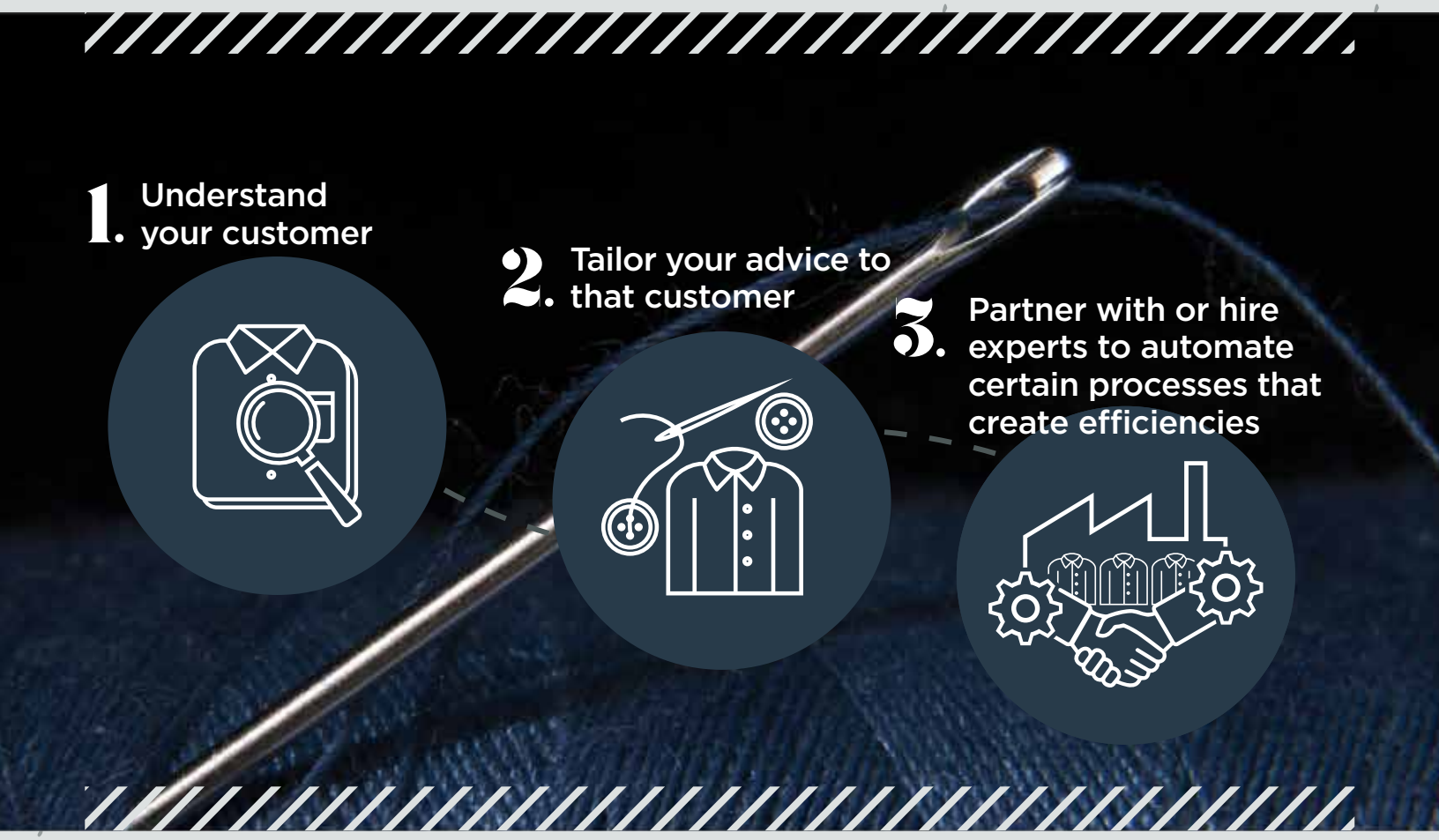
Once you've identified whether your firm will provide product advice or financial advice — or a hybrid — you'll know where to put your resources, and ultimately the marketing messages that attract people to the specific value you provide.

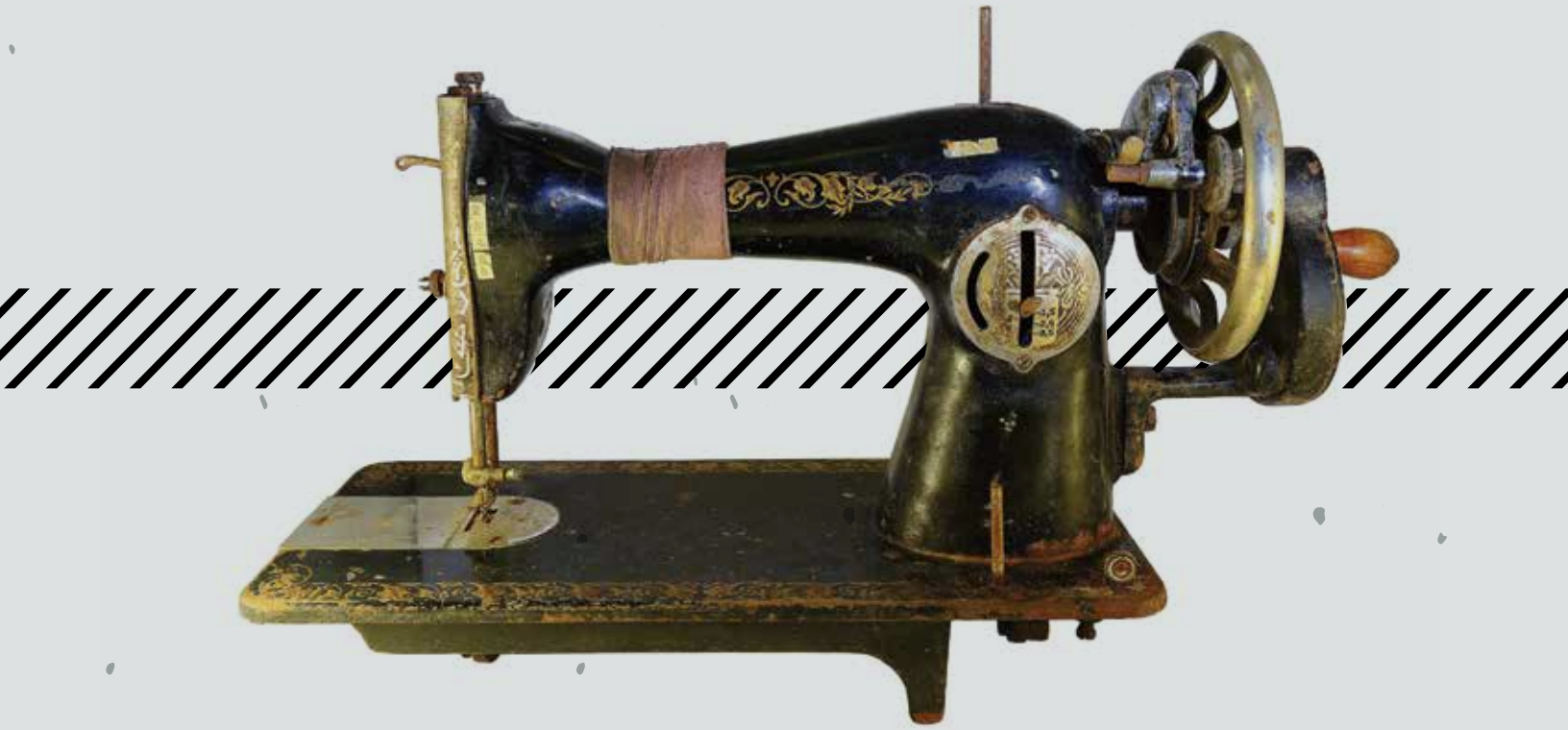
[6]https://www.financial-planning.com/opinion/how-financial-advisors-can-beat-fee-compression

WHAT DOES A MASS-CUSTOMIZED FINANCIAL PLANNING BUSINESS LOOK LIKE?

Think of the Men's Wearhouse approach: define your niche, mass customize your product, and market the value to your niche.

Begin the same way a mass-customized clothing business begins — with a clear understanding of your customer. From there, it involves refining your firm's advice specifically to that customer's interests. This starts with hiring experts, either within your firm or as consultants, who build or identify the best software that automates the application of their expertise. The delivery of the advice provided through these software tools to clients is systematized in a way that motivates clients to take action to improve their situations.





As the financial services industry evolves, the software utilized to deliver recommendations is lacking. The industry's answer to this problem, so far, has been loose integrations among several software tools. "Open architecture" has become a significant talking point. As any advisor who has made attempts at this kind of integration can attest, most are generally underwhelming[7]. For example, if the assumptions underlying a portfolio risk engine materially differ from the assumptions underlying asset classes in a financial planning software, then implementing what looks good in one software can appear awful in another. Theoretically, the two "decision engines" or financial planning calculators should agree, assuming there was similar analytical rigor in the construction of both tools.

Further, what software companies understand but don't communicate to the advisory firms who use their tools, is that the company which controls the data will be most valuable in the future. As a result, software companies have a significant disincentive to fully integrate with other software companies, instead preferring partial integrations that sound good in press releases and meet part of the need, but that protect the enterprise value of the company that is sharing the data.

The combination of these factors will cause fintech companies of the future to vertically integrate, acquiring or developing strong decision engines for each part of the financial planning process and tightly integrating them into a singular system that responds and adapts to each change accordingly, evaluating the trade-offs and iteratively changing the results in one decision engine to account for results in another. The challenge for both financial tech developers and their clients is that each additional decision engine incorporated into the process adds exponential complexity to the calculations that must be performed by the others.

[7]https://www.financial-planning.com/news/planning-software-has-an-innovation-problem-says-michael-kitces

THE MOST SUCCESSFUL ADVISOR USES VERTICALLY INTEGRATED TOOLS

Covisum believes in a future where informing the best financial decisions for institutions, advisors and their clients is possible. We believe this is achievable with vertically integrated technology. We believe this so deeply that we've designed our whole company around it. Our name means "shared vision," because we believe we have a responsibility to provide the best, data-driven financial solutions to advisors and their clients, so they can clearly see together what is the right path.

Our company started as a single tool, Social Security Timing®. This program is built on a strong decision engine that calculates the best answers for client questions about their Social Security benefit strategy. The software calculates thousands of possibilities in a matter of seconds and allows an advisor to use the suggested strategies, alongside customized alternate strategies based on what they know about the client. Using a powerful decision engine is the only way that an advisor can quickly calculate all of the possibilities and come up with a personalized recommendation.

Next, because there was no tax engine capable of showing clients the complicated interactions between different types of income and deductions, leading to significant tax inefficiency in retirement strategies, we created Tax Clarity®. This tool automates a scenario-by-scenario evaluation of tax opportunities on a year-by-year basis to answer client questions about which retirement accounts to draw from in order to most efficiently use assets with different tax treatment throughout a lifetime. The software instantly identifies opportunities for advisors to make an income stream recommendation and add significant financial value to a retirement plan. Without this tool, the amount of time it would take to run this analysis would be prohibitive, and it would be easy to miss opportunities to save clients from compounding tax burdens.

Next, we acquired the SmartRisk™ tool from PrairieSmarts and reworked its institutional-quality risk analytics engine to tailor it to financial advisors. This heavy-tailed risk model evaluates investment risk to properly align a client's risk tolerance with the actual risk in their portfolio. We believe a solid risk discussion is the central element of behavioral coaching, which multiple studies[8] have quantified as delivering Advisor Alpha[9] upwards of 1.5% annually. Additionally, our SmartRisk technology is being used to power portfolio margin lending and has been through extensive FINRA review on its methodology.

[8] http://corporate1.morningstar.com/uploadedFiles/US/AlphaBetaandNowGamma.pdf
[9] https://advisors.vanguard.com/iwe/pdf/ISGAA.pdf?cbdForceDomain=true

Each of these individual decision engines is being woven together seamlessly, or vertically integrated, into a multi-year cash flow, investment, and insurance simulation engine built to evaluate the trade-offs between different financial planning decisions. Covisum will announce the new tool, available for direct subscription or as an enterprise solution, in 2019.

This robust financial planning toolset is not the right fit for all advisors' practices. These solutions aren't designed to be good for everyone. They are designed specifically for advisors who work with mass-affluent and affluent people transitioning into retirement and beyond. Successful advisors will utilize the tools that give them the power to mass-customize their financial advice, similar to how Men's Wearhouse mass-customizes the suits they offer. This robust and data-driven insight will show advisors how to create better retirement outcomes for their clients and grow their business through smart, powerful systemization. The advisors who will succeed in the evolving financial planning industry will do so by identifying a specific group of potential customers who have a core set of decisions to make, helping them make those decisions better than anyone else and effectively marketing the value that a better decision creates.

Advisors who use the Covisum suite are advisors who intentionally choose to be in the mass-affluent and affluent space, serving clients who are nearing or beyond retirement. They are not family offices, and they are not offices focused on serving the needs of millennials. They are advisors who believe their highest calling is helping clients make the best financial decisions and who are prepared to develop specific expertise and tools to answer that call.

Successful advisors will utilize the tools that give them the power to mass-customize their financial advice...

HOW TO PROVIDE MEANINGFUL RETIREMENT INCOME INSIGHTS FOR YOUR CLIENTS

Do you want to be the first to try Covisum's latest tool? Brought to you by the makers of Social Security Timing®, Tax Clarity® and SmartRisk™, our new platform will fully integrate each of our separate decision engines into one seamless process, while calculating the value you've added to your client's retirement strategy. Also, you'll see suggestions for additional adjustments that you could make and add further dollars to their bottom line, truly informing the best financial decisions for your clients. Sign up to be the first to know when it's available at **www.covisum.com/income-insight-learn-more**.

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ABOUT THE AUTHOR

I began as a financial advisor in 2001, shortly after the bursting of the tech bubble. Like most advisors just getting started, I talked to many of my friends and several health insurance clients. I brought my boss to my meetings and watched him explain how we build financial plans. It just so happened that virtually all of those financial plans were focused on identifying needs for life insurance sales and annuity rollovers. It became clear to me that this product-centric approach was not always in the best interest of the client. I didn't stay with that firm.

I spent the next several years in related parts of the industry watching how other employee benefits and financial planning firms operate, and in 2008 decided to build a financial planning practice I believed in — one that puts the client at the center of the decision-making.

As a new advisor, I found the most difficult thing to overcome, even when the course of action seemed completely obvious, was inertia. It's so much easier for people to continue on their current path than it is to make a change. In order to overcome that inertia, I needed to be able to fairly and clearly quantify the value of a different course of action.

To do this, I made a list of all the points in time when individuals in my target demographic — middle- to upper-middle-income people in retirement transition and beyond — have to make a decision or when a default decision is made for them. It's at these points that inertia is weakest. Age 62, the earliest you can claim Social Security; age 65, the age at which you're eligible for Medicare; and age 70½, when required minimum distributions start are good examples of decision points. While these are dates established by law, they provide convenient entry to a discussion that very often represents an opportunity to add quantifiable value to the client's life. After identifying the key decisions my particular target client was making, I set out to identify whether (or not) there was significant value to be added at these decision points. After identifying the variety of Social Security claiming options, I realized that there were no tools at the time that automated the important processes of identifying all of the options available to a client. I built a spreadsheet to do the heavy lifting — identifying the available strategies and the lifetime value of each.

By working through the Social Security decision in this way, our team realized that the current financial planning tools will soon become irrelevant. Virtually all of the financial planning tools in the marketplace rely on the advisor to identify a potential strategy and input relevant features of the strategy into a software, which doesn't take other financial decisions into account. What gets considered and what doesn't get considered as a potential path are entirely the responsibility of the advisor. Thus, an advisor with a particularly high competence in insurance products will most certainly develop a high concentration of plans that include insurance products. This is not ideal. In theory, the entire universe of financial planning options at a significant level of detail should be considered for every client, but doing so is too time consuming and beyond the expertise of any human advisor.

Enter mass-customization.

Because the planning tools were built to "demonstrate" the purchase of a product or investment strategy, they omit significant levels of detail that are highly relevant to the decision. In contrast, an engine that is built to evaluate all of the significant variables of a decision and actually recommend a course of action cannot hide behind oversimplified calculations. During the evolution of financial services, recommendations will require a human advisor to provide a filter, but ultimately an advisor's role will be elevated to relating the optimal decisions back to the client's life and helping the client understand and overcome any emotional influences that would otherwise prevent the client from doing what is in their best interest.

Financial advice is changing and the new environment creates two paths for advisors: either participate in a race to the bottom, maintaining current service levels while cutting fees, or increase the value delivered and identify ways to track and quantify that value. Much of the industry will be involved in a race to the bottom, but there will be significant opportunity for those who choose the latter path.

Covisum builds software solutions that help advisors and financial institutions grow by delivering value to their clients. Our technology empowers advisors to mass-customize plans and fine-tailor them to clients.

COVISUM®