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Tailoring to the needs of HNWIs

IFA Cover Story

Victoria Papandrea

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Meeting the diverse needs of high net worth individuals (HNWI) has long been a challenge for the financial services industry, and the repercussions of troublesome market conditions has added yet another layer of complexity to understanding and servicing this particular group of investors.

In the wake of the market shake-up the investment behaviour of HNWIs has also experienced somewhat of a metamorphosis, where transparency and an inclination to take more of a long-term investment view are now at the forefront of these investors' minds.

A rare opportunity, therefore, is on offer for those financial advisers who are able to successfully provide a superior service and tailor advice to the multifaceted demands of this sophisticated group of investors.

"This sector of the market represents a significant opportunity for investment professionals who are prepared to invest the time and effort to meet the diverse needs of this far from homogenous group," Investment Trends principal Mark Johnston says.

"As investors review the performance of their investment portfolios over the last year and try to position themselves for an uncertain future, it will be those advisers who have acted with integrity and who now show leadership that will be well placed, not only to take advantage of the current market environment, but to establish reputations that will last well into the future."

While HNWIs are looking for high-quality, objective advice from their adviser, it seems some are frustrated at what is currently available to them, according to a recent Investment Trends study.

"We found that across the board there were a few more HNWs saying they were going to use advisers less going forward as a result of everything that has happened through the global financial crisis," Johnston says.

The report, which surveyed more than 1600 HNW investors in November 2008, identified the drivers behind this were largely a result of these individuals wanting better timing of recommendations, better investment decisions and better asset allocation from their adviser.

The study also identified high demand among a significant proportion of HNW investors for additional advice beyond what they were already receiving from their adviser.

"We tended to find on average they'd cite a few different areas each, and across the board about 60 per cent of HNW clients had unmet advice needs, so there were gaps in what they were receiving," Johnston says.

"Among HNW financial planning clients some of the growth areas where there were a lot of people looking for additional advice were around things like borrowing within super, so given asset values are low there are a lot of HNW people taking a longer time view and saying 'well now is the time to look at that'."

Asset protection strategies are the most sought after area for advice that is not currently being received, and there is also a reasonably strong demand from HNW clients for estate planning advice, he adds.

Shadforth Guest McLeod private client adviser Chris Taylor argues one particular area advisers are yet to appropriately address is around helping HNWIs coordinate their overall financial affairs.

"I think there's a massive hole in that market. I just don't think it's being addressed properly by advisers. It's a market that's out there for the taking and we are really positioning ourself to do that big time," Taylor says.

"So we see our function, from a fee-based perspective, as taking that individual and coordinating all of those parts.

"Now whether that means we talk to the accountant, the stockbroker, the mortgage or insurance broker, we sit in the middle of this whole thing and we make sure that the client is protected and looked after as a primary focus."

He adds the niche one-stop-shop service of a family office for HNW clients will become a stronger proposition for financial advisers to consider in the future.

NAB Private Wealth head of strategy Tim Chilvers agrees. "It's as critical now as it's ever been and will become more so," Chilvers says.

"We are finding that every client we speak to, who may have considered building their own family office offering outside of the system because their needs were not being met, have embraced our offering with open arms, and there's been a lot demand for what we've built and what we are building."

The HNW sector comprises a broad spectrum of investors, ranging from individuals with more than $1 million in investable assets, right up to the ultra-HNWs, who have more than $10 million in investable assets.

Therefore, a broader range of services is required to service HNW investors the more you move up the client value spectrum, Chilvers says.

"As we move further up the segment into the ultra-HNWs, the ability to meet their needs with off-the-shelf product is really difficult," he says.

"The NAB response to that has been to bring our capabilities that were typically reserved for institutional-style investors, and translate that through our ultra-HNW and national family office portal into a form that's relevant and implementable by HNW investors.

"So institutional capability is brought to that target market in a way that makes sense to them, and it gets a lot of traction because very few people are doing it."

MLC investment platforms executive general manager Michael Clancy adds HNW clients tend to have quite specific needs when it comes to investment products.

"Some of that need is actual need in that their circumstances are genuinely different or unique because of where they are and the issues that they face, and that client base certainly likes to see investment products which are not necessarily available to the whole market," Clancy says.

"So they might like to see the special products that may only be offered to institutional clients or clients that can be treated like institutions, or they may be interested in maybe some structured products and maybe some unique products that aren't generally available in the market.

"A good many of those products are fine and some of those products end up, with the benefit of hindsight, not working out that well."
The bear market has resulted in HNW investors increasingly shying away from investing in exotic products, he observes.

"I'm always fascinated by the very HNW private client market. In most instances they are your most valuable clients, but they end up getting the worst of everything thrown at them and they love it because it's different, it's the newest, it's the most exciting, the most fashionable, the most expensive, and in so many instances it ends up being bad for them," he says.

"I think through this market it is a great reminder to everyone that not all great ideas work out; there are laws of physics when it comes to investing."

Instead, Chilvers says HNWIs are now valuing transparency, predictability and capital stability.

"In times gone by, all HNW individuals have sought exclusive product. In the past this exclusivity needed to be partnered with both sophistication and very often a structured nature," he says.

"What I would say today is that the need for exclusive product prevails and sophistication is still something that they are looking for, but a little bit more transparency and the ability to see through the surface of whatever we're offering to what's underlying it.

"Capital stability is something that is very much in the front of HNWs' minds, but they are also trying to maintain as much yield as they can without going too far out on the risk spectrum."

HNW investors are now more inclined to want to know their objectives and goals are being met by the strategic advice they are receiving from their adviser, according to Taylor.

"I think HNW individuals are just very tired of receiving stock picks or particular stocks, they are very tired of exotics, they are very tired of trying to get tax concessions out of agribusiness, they are very tired of being confused by a number of exotic products that, at the end of the day, quite often don't work," he says.

"I think they are less concerned now about getting obscure and exotic solutions to an equity exposure, for example. I think they really now want simple stuff where they've got a broad diversification where the risk-reward scenario is far more identifiable.

"People are fairly tired and fairly weary with being presented with such a massive range of options by product promoters to try and beat the system. I think that a lot of the things that they have done have not necessarily produced the results that they thought they would."

The global financial crisis has also caused HNW investors to reflect on whether they want a simple investment solution to their problems, he adds.

"So that means putting in front of them investment product solutions that they are comfortable with, versus things that are outside the square and may attract certain tax advantages," he says.

Clancy says the best thing an adviser can do when servicing the advice needs of HNW clients is to treat them as individuals and really understand their circumstances in order to provide a tailored solution.

"You're tailoring not only the advice service but also the products to the individual needs of the client or the family who is the client," he says.

Chilvers agrees, noting that sometimes a particular family group will have members that have both of those profiles.

"One of the key aspects facing wealthy families is the transition of wealth through generations, and not every generation is as prepared as the one that's gone before them to deal with the complexity of the wealth that they will inherit, so we have services aimed at ensuring that transition is appropriate as well," he says.

"Our model is about building an effective partnership and delivering the services in a way that makes sense for each HNW investor. It's not a cookie-cutter approach; it is absolutely tailored to every particular client."

Furthermore, Wealthsure Financial Services chief executive Darren Pawski argues the approved product lists of some of the institutionally-owned dealer groups are fairly limited for HNW clients.

"HNW clients want independence. They have got a lot of money and they don't want it just in that one product or that one range," Pawski says.

"HNWs want products that are based on independent merits where there's no ownership, there's no conflict at all and I think particularly the very HNW clients are really looking for that advice."

Chilvers admits the approved product list for the retail investor will fail to serve the ultra-HNW client base.

"Which is exactly why we've created our new wealth services, with a chief investment officer whose specific mandate will be to build an approved product list and investment philosophy specifically aimed for HNWs," he says.

"We're building our investment offering client by client as we speak, and one of the chief investment officer's responsibilities will be to ensure that what's available through NAB private wealth continues to evolve such that it meets the requirements of the ultra-HNWs in our client base."

However, Taylor says having an approved product list is not necessarily a negative thing.

"But it's got to be a product list that has products that will suit that individual and not be influenced by the institution who is providing the service," he says.

"If you've got an institutionally-owned group, then clearly the advisers will be rewarded for using that institution's products. Now that doesn't say they are good or bad, it just means that they are being rewarded for supporting the institution.

"So whether there is an approved product list with 1000 products on it or 10 products on it, it really matters more what those actual products are on the approved product list."

On the other hand, Johnston observes a more limited approved product list does seem to act as a barrier for the HNW market.

"We ran another piece of research in October 2008, which looked at advisers based on their average funds under management per client," he says.

"In that report it's very clear that the HNW-focused advisers are more likely to come from more smaller, boutique independent firms and they tend to advise on a much wider range of products," he says.

Pawski concurs. "I think when times are harder it certainly goes more in the favour of the independent advisers because they are not mandated to treat effectively all clients," he says.

"With HNW clients, if you try to put them in a box then you're going to have a problem because they didn't get HNW by being in a box, so you really need to be able to address their individual needs rather than just with products."

HNWIs can be quite demanding with their advice wants, and at times these wants are not necessarily aligned to their advice needs.
Therefore, some believe advisers from institutionally-owned dealer groups are perhaps more likely to be intimidated by providing HNW clients with what they want, rather than what they need.

"I do think it happens, and it comes back to a product supplier versus an advice giver. Advisers and brokers that work for big institutions that provide product are rewarded by providing a product, not the advice," Taylor says.

"If enough marketing is done by a company to entice the HNW or any other investor to look at that company's products, then clearly the adviser is going to be rewarded for supplying product, not necessarily supplying advice," he says.

"So they will listen if a HNW individual walks in and says, 'I saw this advertised I want to invest in this'. It's highly unlikely that the adviser that works for the institution is going to argue or disagree, because they will be rewarded."

However, Chilvers observes NAB private wealth advisers are not at all constrained by HNW clients dictating what they want.

"We have a model that starts with the client's needs at the centre and the client experience bears that out," he says.

"As a practical matter, sometimes that plays out as curtailing the enthusiasm of clients in rising markets and comforting clients through falling or volatile markets.

"It's all about understanding the risk profile of the client, setting meaningful goals and objectives and helping the client to understand that those are goals and objectives that will hold through cycles and continue to play out with what you've set out to achieve in the longer run."

Clancy agrees. "Sometimes that can be really hard especially with the HNW clients. These are very often very successful people who have been successful because they've made many good decisions themselves," he says.

"So being prepared to give them real advice is sometimes really hard if they're interested in things which might be fashionable for a period of time but actually aren't good long-term investments.

"To provide good-quality advice means that you have to as an adviser have a solid view about issues and be prepared to say no to your client in the right circumstances, if the client is asking for something because it's merely popular or because somebody else they know has a product like that.

"It doesn't matter if it's a HNW client or a much smaller client, those situations happen and a real adviser's job is not to just pander to every whim of their client, but to provide them genuine advice, and I think we try to instil that within the MLC dealerships and certainly in the private bank."

Chilvers says the most important personal quality necessary to be effective in the HNW space is an adviser's ability to have a peer-to-peer conversation with the bank's wealthiest clients.

"If you can't do that, then your ability to deliver sound advice to successful people will not be what it should," he says.

Pawski concurs: "If you're not transparent and able to provide superior service, then the HNW will work that out pretty quickly.

"Some advisers want to be in that HNW area, but are not necessarily going to make that step. Everyone talks about that they want to deal with HNW clients, but actually getting there and maintaining that, that's another issue."

The Investment Trends report also identified attributes HNWIs looked for in an adviser, Johnston says.

"When you ask them in their own words they tend to talk about trust a lot; so someone who is sort of speaking on their level; they tend to talk about the knowledge of the adviser, which is a combination of product knowledge, market knowledge, technical understanding as well as tax, so all of these things came through strongly," he says.

"They tend to talk about honesty. A lot of that is not so much around remuneration, but more around being independent and unbiased."

A majority of HNW investors can be considered opportunistic, financially savvy individuals, and this also plays a part in influencing their investment decisions.

Chilvers says HNW investors are more inclined to think ahead of current market conditions and act with conviction compared to other investors.

"HNW investors are more inclined to back themselves into bold decisions, as you would expect of successful people, than perhaps people in other segments that we serve," he says.

However, Taylor argues the market dictates what investors do and HNWIs' investment decisions do not lead the market.

"I believe the markets are efficient. I just don't believe that there are people that can consistently be in front of the market, or in fact individually or in small numbers drive what the market is going to do," he says.

"People are reactive; they are not proactive. They don't lead the market. What happens is they follow a herd mentality."

However, the Investment Trends survey found HNW investors in the $2.5 million-10 million range were more likely than others to be buying opportunistically earlier.

"So I guess that group really did lead the market," Johnston says.

However, HNW investors in the $1 million-10 million bracket were a little less reactionary to what was going on in the market, he says.

"These HNWs were actually more likely than other investors to say that they were planning to stick to their long-term investment strategy," he says.

"There were also a few more of the ultra-HNWs actually staying on the sidelines a little bit longer and sitting on cash.

"Bear in mind the research was really run at the height of the bear market around November, so at that stage of things that's what it was looking like."

The report found HNW investors saw the market downturn as an opportunity, with 38 per cent actively buying assets they believed were undervalued and 40 per cent accumulating cash while waiting for the markets to calm down.

Johnston says during the financial crisis, advisers tended to encourage clients to buy into particular assets while they were cheap, however, HNW investors have tended to fall into two different groups.

"One camp is saying, 'yes, that's a good idea, I'm going to do that'; the other camp though have really gone to the sidelines and said, 'things are just too volatile, I'm just going to accumulate cash and wait for them to settle down'," he says.

"So often the advisers are saying, 'well we're telling the clients that it's a good time to invest, but trying to get them over that is quite challenging', and so we've seen growth in particular areas that are a solution to that.

"For example, there's quite a number of advisers saying they're going to make more use of structured products going forward."

A recent Datamonitor survey indicated HNW investors are expected to have up to a quarter of their total investment portfolio in direct equities in the next two years.

The survey found wealth managers servicing the financial needs of HNWIs expect more than 90 per cent of their clients will demand direct equity investments over the period.

"If the stock market continues to rally this year, we should see a wave of new investment from HNW individuals, while many will have learnt lessons from the equity crash, ultimately this will not discourage them," Datamonitor wealth analyst David Lalich says.

"These are typically opportunistic individuals that want exposure to the best opportunities for growth in the market."

With client demand expected to be strong in the area of direct equities in the next two years, 44 per cent of wealth managers surveyed said they would focus their resources into these investment products in that period.

A smaller percentage of wealth managers said they would focus on developing other investment areas, such as property funds, capital-protected funds, exchange-traded funds and currency trading.

Johnston adds exchange-traded funds are finally gaining some traction in the Australian market, predominantly driven by demand from HNW investors.

"It's still small but it's starting to grow quite rapidly, which was not something we'd seen before; higher income and HNWs are kind of driving that particular growth," he says.