Assessing the Strength of the Advisor-Investor Relationship

A Groundbreaking New Method

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Executive Summary

Conventional wisdom suggests that the primary reason clients switch from one investment firm to another is under-performance of their portfolio under management[1 2]. Recent research conducted by J.D. Power & Associates,[3] however, reveals that the quality of the relationship between an investor and his or her advisor is the single most important factor when it comes to client retention, referrals, and the amount of funds clients choose to place under an advisor's care.

J.D. Power recently partnered with Dr. David Garfield and Dr. Daven Morrison from Applied Psychoanalytics to develop and validate a promising new tool that can reliably assess the strength of the advisor-client relationship and indicate which areas of communication and trust need improvement. The tool is called the Financial Advisor Strength Index (FASI).

The benefits of having such a tool have only increased since the start of the Great Recession in 2008, when investors became acutely aware of the risks they were taking.

Prior to 2008, many investors tended to be either fairly passive – i.e., leaving much of the work to the discretion of the advisor – or self directed, making the majority of their investment decisions on their own. When the market fell sharply at the start of the recession, both types of investors began to move towards the middle, looking for someone to guide them in making their own investment decisions.

At the same time, research shows that advisors tend to seriously overestimate investor knowledge, believing 42% of their clients are extremely knowledgeable about investing, while only 12% of investors actually see themselves as such[4]. Consequently, what financial advisors intend as clear and valuable communications are often perceived by their clients as promotional. In another significant disconnect, advisors tend to misunderstand their clients' investment style, assuming clients want to invest more aggressively than is often their preference.

[1] *The Millionaire's Advisor: High-Touch, High Profit Relationship Strategies of Advisors to the Wealthy*, by Russ Alan Prince and Brett Van Bortel (2003) published by Institutional Investor News

[2] Ameriks, J & Fore, D (2002) On the Issue of Advice, Benefits Quarterly, fourth Quarter vol 18 issue 4 p6-16

[3] *J.D. Power & Associates 2013 U.S. Full Service Investor Satisfaction Study*

[4] Vasan Paula, (April 2013) What Investors Get Wrong About Clients. Published in Financial Planning at http://www.financial-planning.com/blogs/What-Advisors-Get-Wrong-About-Clients-2684094-1.html

This creates a real problem for advisors: If they assume their clients know as much about the market as they themselves do, they will not take the time to establish the kind of rapport and focus on communication necessary for a truly productive relationship. As a result, the best advice in the world may not be received or acted on by the investor. The advisor will not get the levels of trust nor assets that ultimately drive business performance for the investment firm.

Until recently, the financial investment industry did not have an empirically validated tool for assessing advisor competencies when it came to building positive and long-lasting client relationships; now, with FASI, it does.

- Using FASI scores, investment firms can now identify and help their advisors build stronger client relationships and maximize greater lifetime client value.
- The FASI can also serve as a leading indicator of business success for advisors, as it reflects an individual advisor's ability to create the kind of strong relationships that lead to better outcomes for both advisors and their clients.
- FASI scores have vital implications for financial advisor training and professional development.

Borrowing from Psychotherapy to Measure the Investor-Advisor Relationship

To assess the strength of the advisor-investor relationship, Garfield and Morrison drew upon psychotherapy research, which shows that the most reliable predictor of treatment success is the client's view of the strength of the relationship between the patient and his/her therapist.[5] [6] Furthermore, there are several important similarities between the therapist-patient as well as the advisor-investor relationship. For example, both are intensely personal yet professional in nature (e.g., therapists know intimate details about their clients' emotional and psychological wellbeing, while advisors are familiar with the intimate details of their clients' assets and financial wellbeing). In both relationships, success in achieving the desired outcomes is predicated on understanding and connecting with clients on an interpersonal level in order to develop unique customer- or patient-centric plans. Achieving this connection requires not only that the therapist and advisor have the requisite knowledge but also the ability to develop trust and confidence in the patient or client. Finally, for both therapists and financial advisors, if a

[5] Horvath, Adam O.; Symonds, B. Dianne (1991). Relation between working alliance and outcome in psychotherapy: A meta-analysis. Journal of Counseling Psychology, Vol 38(2), 139-149

[6] Tyron, G and Kane, A. The Helping Alliance and Premature Termination. Counseling Psychology Quarterly Vol. 33; Issue 3. Pp. 233-235

foundation of receptivity and trust is not established through good bedside manner or people skills, it is less likely that they can help their clients achieve their goals.

Having spent decades evaluating and training psychotherapists through trust-building and confidence-building, Garfield and Morrison applied their experience to financial advisors. They proposed that any evaluation of the strength of the advisor-investor relationship must cover six important skill sets: teamwork; goal alignment; respect; communication; durability of the relationship; and value of goals achieved. To measure each skill set, Garfield and Morrison constructed a 26-item FASI that requires investors to use a seven-point scale to rate the frequency and degree in which their advisors engaged in various relationship activities across each of these six skill sets.

Research Design

Before any assessment instrument can be used in practice, there must be evidence that it is both statistically sound and a source of useful information. To determine this, researchers from J.D. Power administered online the 26-item FASI instrument to nearly 1,500 individual clients from eight major investment firms[7] . The 26-item instrument took less than five minutes to complete and was fielded in February 2013. The clients who completed the FASI instrument had also previously completed the J.D. Power 2013 Full Service Investor Satisfaction Study, designed to identify the dominant factors that impact both investor satisfaction and behavior. The combination of these two unique data sources leverage data from the overall investor experience with the advisor-focused FASI instrument.

Statistical Analyses Used To Validate the FASI

Using the resulting data, J.D. Power conducted a series of statistical analyses to evaluate the construct and predictive validity of the FASI.

Construct validity means that the measuring instrument being employed actually does assess what it is designed to measure. For example, an instrument designed to measure a person's mood would quantify whether they are happy, sad, depressed, anxious, etc. Predictive validity means the results from the assessment can predict or explain an important outcome. A classic example of predictive validity is the relationship between results from the SAT exam and a student's college performance.

[7] Clients of the following firms were included in the FASI analysis: Ameriprise Financial, Charles Schwab, Chase Investment Services, Edward Jones, Fidelity Investments, Merrill Lynch Wealth Management, Morgan Stanley Wealth Management and Wells Fargo Advisors.

The first step in assessing the validity of the FASI was to determine whether the 26 items actually measured the six separate skill sets proposed by Garfield and Morrison (teamwork, goal alignment, respect, communication, durability of the relationship, and value of goals achieved). Using the statistical technique of confirmatory factor analysis (CFA),[8] J.D. Power researchers found that many of the 26 items did not align with the six separate skill sets and should be dropped. Determining which items to drop required an iterative statistical process that resulted in the removal of 15 items.

Next, J.D. Power conducted another CFA with the remaining 11 items to determine whether these items aligned with the proposed six skill sets. Results from these analyses produced five separate skill sets: teamwork, alignment, respect, communication, and durability of the relationship.[9]

The final step was to determine the predictive validity of the FASI. To assess this, respondents' scores were calculated for each of the five skill sets as well as their total FASI scores by adding the individual items for each of the five skill sets and then averaging these five skill-set scores to obtain an overall score.[10] Scores were also created for each of the eight major investment firms by aggregating the scores of their investors and then weighting them based on the number of customers who use the firm as their primary investment firm.

How FASI Scores Relate to Key Business Outcomes

The most important question is whether FASI scores are related to key business outcomes, such as client retention and the total value of assets under management. To determine this, we first classified respondents into two groups based on their FASI ratings: Group 1 consisted of investors who rated their advisor as having strong relationships skills (e.g. above average FASI scores); Group 2 included investors who rated their advisor as having weaker relationship skills (below average scores).

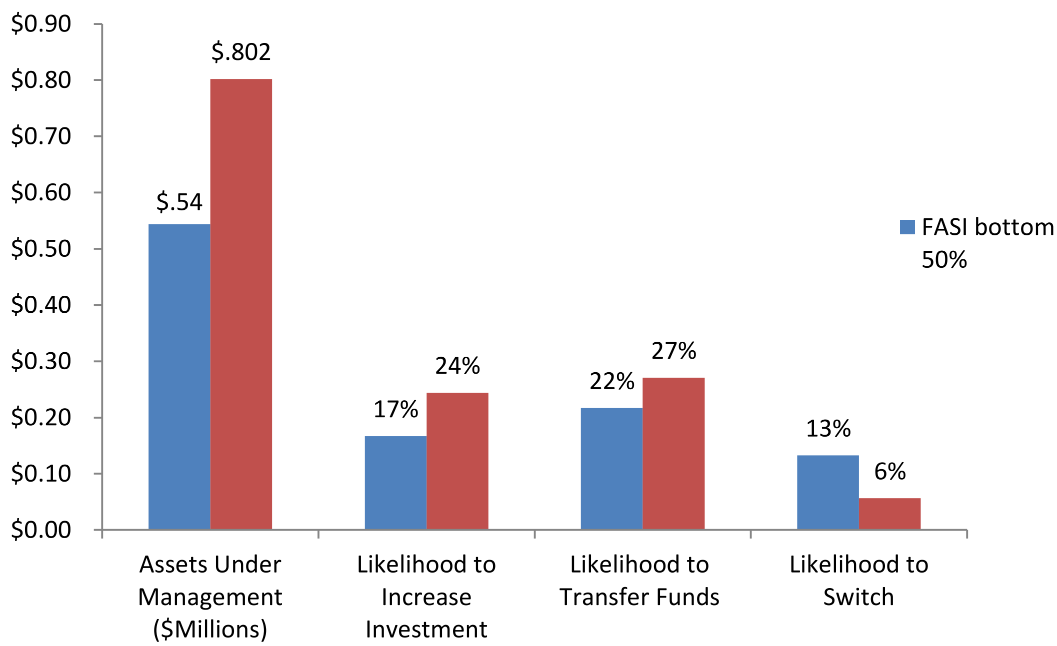
[8] Confirmatory factor analysis is a statistical technique used to determine whether the data fit into the structure or model proposed by the researchers. It is based on assessing the inter-relationship among the individual items and evaluating whether the individuals items align with the number of factors that were originally proposed by Drs. Garfield and Morrison

[9] The sixth proposed skill set, "value of goals achieved," cross loaded on many of these other dimensions, suggesting to us that this could be not a skill set but an outcome of each of the other five.

[10] Because the 11 questions were based on a one-to-seven point scale, the total scores ranged from 11 to 77 points. For ease of use, we applied a simple linear transformation, so the scale would range from a low of 10 to a high of 100 points.

The results from this comparison were striking. Respondents who rated their advisors as having strong relationship skills (high FASI scores) reported more assets under management with that advisor ($80K vs. $54K), were less likely to switch to another advisor (6% vs. 13%) and were more likely to invest (24%) or transfer additional funds in the future (27%). In fact, investors who said their advisors had strong relationship skills had nearly a third more assets under management than those reporting weaker relationship skills (see Figure 1).

Figure 1



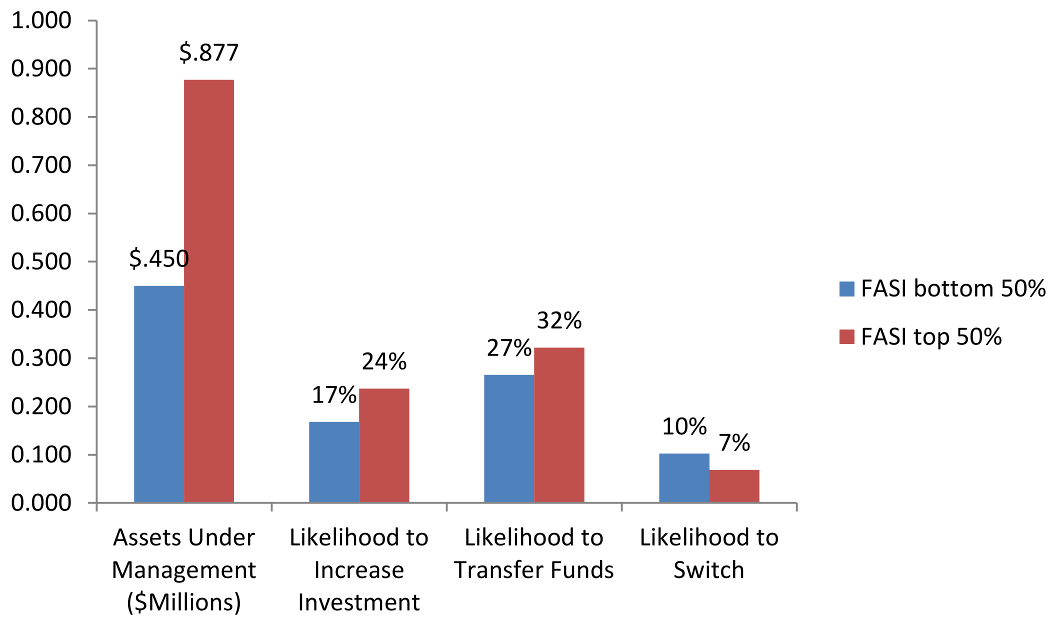
A reasonable question to ask is whether FASI can explain or predict business outcomes beyond what can be predicted or explained by other outcomes. One measure that J.D. Power has consistently found to be predictive of various business outcomes is investor satisfaction with the firm and the advisor. So as an additional assessment, we examined whether FASI could explain key business benefits beyond what can be explained by an investor's level of satisfaction. To assess this, we looked at only those investors who reported being highly satisfied with their advisors and then divided these highly satisfied clients into two groups based on their FASI scores (high vs. low FASI).

The results from this comparison showed that even among highly satisfied investors, a strong advisor-investor relationship yielded substantial business benefits. In fact, highly satisfied investors that also had strong advisor relationships had:

1. Nearly twice the amount of funds under management;
2. Greater likelihood of investing more funds in the upcoming year; and
3. Said they were less likely to switch.

This assessment adds further validity to the predictive value of FASI scores.

Figure 2



So far, the results show that FASI scores can explain business outcomes over and above the benefits explained by high levels of satisfaction, but can FASI explain outcomes beyond behavior? To answer this question, we examined six key performance indicators (KPIs) that reliably explain an investor's satisfaction and his or her willingness to invest. These KPIs include the development of an investment plan by the advisor, putting such plans in writing, and discussing and incorporating the investor's risk tolerance into the portfolio. Not surprisingly, advisors who performed well on all of the KPIs had better business outcomes as well as higher satisfaction ratings, but when we examined each level of KPI execution (Figure 3) from doing all of these desired actions (0 missed KPIs), to doing none or only one (missed five or more KPIs), investors with strong advisor relationships gave their advisors a greater share of their assets, and were more willing to invest more in the future than those with weaker relationships.

Figure 3

Number of Missed KPIs	FASI	Likelihood to Increase Investment	Likelihood to Transfer Funds	Likelihood to Switch	Assets Under Management ($Millions)	Share of Wallet
0	bottom 50%	22%	28%	3%	1.06	84%
0	top 50%	30%	29%	2%	1.19	87%
1	bottom 50%	21%	31%	9%	0.71	88%
1	top 50%	27%	30%	6%	0.88	89%
2	bottom 50%	21%	24%	10%	0.60	87%
2	top 50%	27%	26%	4%	0.65	91%
3	bottom 50%	20%	20%	12%	0.61	88%
3	top 50%	13%	21%	5%	0.53	91%
4	bottom 50%	13%	18%	12%	0.37	89%
4	top 50%	19%	30%	15%	0.48	91%
5+	bottom 50%	10%	17%	21%	0.39	86%
5+	top 50%	20%	18%	14%	0.73	88%

Conclusion

The erosion of investor trust since the recent financial crisis has led to an increased need for advisors to understand and develop deeper, stronger relationships with their clients. Until now, however, the industry has not had a valid tool for assessing advisor competencies when it comes to building such positive and long-lasting client relationships. The good news coming out of this research is that investment firms now have FASI scores to help identify their advisors' strengths and weaknesses in building relationships. Using FASI scores, firms can now focus on their advisors' relationship skill sets using a proven scientific method, thus maximizing the lifetime value of their clients.

The FASI can also serve as a leading indicator of business success for advisors, as it reflects an individual advisor's ability to create strong relationships. For this reason, FASI scores have potentially important implications for financial advisor training and professional development. As a result, educational and development programs for financial advisors will now be enhanced in three measurable ways:

1. Teaching financial advisors "people skills" moves beyond less defined concepts, such as "coaching" and "trust building" -- programs that may not be directly related to business outcomes;
2. The FASI provides organizations with a trusted tool to gauge the impact of their advisor-client programs, allowing them to benchmark existing skill levels while quantifying real progress in achieving higher ones; and
3. By incorporating the FASI metric along with the financial advisor satisfaction scores, firms and individual advisors can employ targeted and easily customized educational programs that are able to adjust to each advisor's specific learning needs.

The findings of this research demonstrate that the Financial Advisor's Strength Index is something unique and new to the market: A truly innovative and valid relationship metric that strongly correlates to key business outcomes, such as increased assets under management, new client referrals, and client retention with measurable people skills.

FASI is an essential tool that financial firms have long needed but did not have access to before, with the potential to revolutionize the investor advisor/client relationship.

About the Authors

Gina Pingitore, Ph.D., is vice president and chief research officer at J.D. Power. She is responsible for the scientific rigor and oversight of the design and statistical analyses for all syndicated and proprietary studies. Ms. Pingitore joined J.D. Power in 2002 and holds significant leadership roles in research and science. During her tenure at J.D. Power, she has developed models to establish the relationship between various voice-of-the-customer measures and business outcomes. More recently, she has focused on measures of customer engagement through database scoring as well as leveraging social media to listen and learn what consumers need. Ms. Pingitore was a licensed clinical psychologist and behavioral researcher and has authored over 60 articles in academic and industry journals. She received a master's degree in psychology from Edinboro University of Pennsylvania, and a doctorate in psychology from Loyola University of Chicago.

David Garfield, MD, is the founder of Applied Psychoanalytics, creator of the original FASI, a Professor of Psychiatry, and a Psychoanalyst. He is the author of “The Psychology of Smart Investing” and several other books on psychotherapy and psychoanalysis. He has been director of the professional development program for Psychiatry at the Chicago Medical School for 25 years.

Rockwell Clancy, MBA, is vice president of Financial Services at J.D. Power. He oversees the company’s syndicated studies, proprietary research, consulting, and performance improvement programs for consumer financial services. Mr. Clancy is the author of numerous articles and reports on the shifting underpinnings of customer experience, links between customer satisfaction and shareholder value, and key strategic challenges facing the financial services industry. He is also a frequent speaker at domestic and global industry conferences and is frequently quoted in leading consumer and financial services publications. Mr. Clancy’s career spans more than 30 years in the financial services industry, both as a banker and a consultant. Prior to joining J.D. Power, Mr. Clancy held positions at Sheshunoff Management Services, Bank Administration Institute, Bank One and First Illinois Corporation. Mr. Clancy earned a bachelor’s degree in English literature from Northwestern University and an MBA from the J.L. Kellogg Graduate School of Management at Northwestern University.

Daven Morrison, MD, is a partner in Applied Psychoanalytics, and an advisor to financial advisory service firms, banks, insurance companies and other professional service firms. His work experience includes leadership development of C-suite executives. He is on the faculty of the Midwest Leadership Institute and is a committee member of the Group for the Advancement of Psychiatry. He is past president of the Academy of Organizational and Occupational Psychiatry. Applied Psychoanalytics has provided leadership development for over 1,500 senior leaders. He is a co-author of “The A.B.C.’s of Behavioral Forensics: Applying Psychology to Financial Fraud Prevention and Detection.”

Suxi Li, Ph.D., is senior manager at the Analytical Center of Excellence at J. D. Power. He is responsible for developing customer satisfaction index models and conducting advanced statistical and econometric analysis. Dr. Li joined J. D. Power in 2007. He works with practice leaders and research teams in different countries (the U.S., Canada, China and Japan) to identify research needs, and he provides guidance on questionnaire design, survey methodology, sampling planning, and research best practices. He develops consumer insights and data-based recommendations to help financial institutions improve customer experience and gain market competitive advantage. Dr. Li earned a doctorate in economics from the University of Miami.