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How Denver wealth managers are dealing with fee compression

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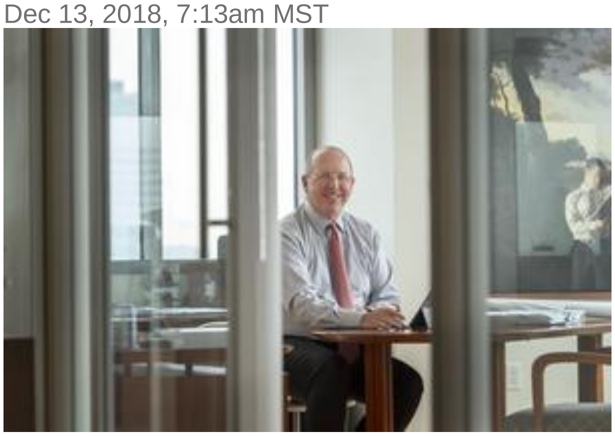

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Scott Wylie is CEO, Chairman and President of First Western Financial.

Throughout the country, wealth management firms are dealing with fee compression, or the lowering of the fees people will pay to have someone mind their investments.

And Denver is no different, say local wealth management leaders such as Don Bechter, managing director of the Denver office of RMB Capital, an investment and advisory firm based in Chicago.

“We have a lot of quality competition and good firms in our market that are subject to the same industry dynamics,” Bechter said.

He and several local wealth managers who spoke with Denver Business Journal cited the Great Recession, technology improvements and increased interest in passive interest for reasons behind fee collapse.

But they also all cited strategies that could help the industry continue to grow.

Role of wealth managers

Wealth managers help clients decide what to invest in, said Scott Wylie, Denver-based First Western Financial’s CEO, president and chairman. Wylie said its business model differs other banks' in that First Western is a wealth management company built on a banking platform.

“It is human nature to emotionally sell losers and buy winners, but we all know that a key driver of long-term performance is buying low and selling high,” Wylie said. “Professionals help provide the strategy and discipline many of us need to avoid making mistakes given the emotions of the day.”

But not all wealth managers have acted professionally in the past, Bechter said.

“The investments management [and] wealth management industry has a long history of confusing and in some cases hidden fees that have created conflicts of interest between the advisor and client,” Bechter said. “Consumers of these services have become more educated, especially since the financial crisis, and are demanding more transparency so they can understand better the value they are getting for the services they are receiving.”

He said the most extreme fee compression has come from the investment side of the business, with regard to transaction costs and commoditized products such as index funds and exchange-traded funds. Furthermore, Bechter said wealth advising has seen more competition from automated robotic advisors who can provide basic financial planning services.

Active vs. passive management

Technology more than ever allows for the passive management of wealth, Wylie said.

Active management involves selecting individual securities for a client, whereas passive management involves buying a representative mix of a whole index without any qualitative screen, Wylie said.

“When markets are choppy and volatile, active managers often outperform passive managers,” Wylie said.

But actively managing any asset class is much more time-consuming and difficult, Wylie said, therefore making it more expensive than passive management.

In the long-term bull markets like the current one that U.S equities have seen for most of the past 10 years, passive managers often perform as well or better than active managers for a cheaper price, he said.

“People then learn about ‘cheaper, better managers’ with passive management, and that's what they think they want,” Wylie said. “Thus the fee compression for investment management services becomes an issue, and as people shift to low-fee passive products, fee pressures intensify on active managers.”

Fred Taylor, president and co-founder of Denver-based Northstar Investment Advisors, predicted that in the not-too-distant future, equity trades will be free and brokerage firms will have to make money on securities lending or money market funds.

“There is definitely a race to the bottom in terms of fees with passive investing,” Taylor said. “Vanguard, Schwab and Fidelity continue to cut the fees on their index and exchange-traded fund products. On a few funds Fidelity doesn’t charge any fees.”

How are Denver managers responding?

Denver-area money managers are addressing the issue of fee collapse in their industry in different ways.

“Many are raising minimums to limit access for smaller accounts,” Wylie said. “If the only thing you do is active management, then obviously proving the value of active management and the corresponding higher fees is a big problem if you aren't demonstrably providing consistent value above passive managers — which has been tough over the past several years.”

He added that First Western Financial has not and does not plan on taking this approach.

“At First Western, we believe long-term performance is more about understanding individual goals and risks, solid wealth planning, broad diversification, managing total fees, and disciplined implementation than chasing the latest and greatest money management trends or the hottest managers of the day,” Wylie said.

First Western Financial has passive managers as an alternative to active managers in many of the company’s different asset classes, so its portfolio managers and clients have choices between the more hands-on approach of active managers or the lower fee approach of passive managers.

Wylie said that people seeking wealth management services should look for wealth managers who work to eliminate unnecessary services and minimize fees, whatever the market climate might be at any moment.

When markets are volatile, "people typically find much more value in really good wealth management than when the markets are going straight up,” Wylie said.

Bechter agreed, saying that the industry has been through a long stretch where there wasn't been much that investors could get excited about.

He said the expensive nature of the stock market and the low-yield environment for bonds since the Great Recession has made it difficult for active investors to find attractive opportunities.

“However, we have been preparing our clients for the recent volatility for some time now, counseling them to be prepared and in many cases to make dry powder available to take advantage of a possible market correction,” Bechter said.

Technological enhancements

Bechter said one way RMB Capital is dealing with fee collapse is through improving technology.

He said that his firm has invested heavily in technology to improve efficiency and keep fees low. “One example of this is our new mobile app which not only greatly improves the workflow and ability of our advisor teams to service our clients but also allows our clients access to all their information at their fingertips, anywhere, anytime: account balances, holdings, performance, etc.,” Bechter said.

Bechter added that increasing transparency about fees has helped his firm stay competitive.

“We want them to understand the entirety of the fees they are paying to us for wealth management and investment advice as well as costs from any third-party investment strategies we might recommend to them as part of a customized allocation,” Bechter said. “We also want them to understand options we may have to help them lower their investment costs and any trade-offs that may entail.”

Conversely, focusing on what technology cannot replace was also cited as a way to beat fee collapse.

Bechter and Taylor both cited personalization as a way to avoid fee compression.

Bechter, for example, said his firm limits the number of clients served by each advisor.

“Our focus is on providing a level of service and advice so that our clients feel they are receiving value exceeding the fee we charge them,” he said.

Taylor said his firm provides this personalization by not outsourcing its money management research.

“We buy individual equities and individual bonds to meet the income needs of our clients who are living off their portfolios,” Taylor said. “We don’t need to cut our fees because in most cases we are already considerably cheaper than our competitors.”

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