CAPCO

GOAL-BASED PLANNING:

A CLIENT-CENTRIC APPROACH TO WEALTH MANAGEMENT

PERSONAS

Eric is three years away from his retirement. With his wife already retired, he meets with his advisor to discuss their retirement plans. These plans entail downsizing their house, putting some of the proceeds into a trust fund for their children, making annual contributions to their grandchildren's registered education savings plans, and securing cash flow needed to sustain their lifestyle when he joins his wife in retirement. They also planned several trips that they never had a chance to take due to their careers and busy schedules. They want to make sure they will have enough put aside to fulfill these dreams.

Kim is a recent university graduate. She just started her career in advertising, and she would like to pay off her student loans as soon as possible. In addition, she is planning a few trips she would like to take in the next few years. Most of these trips are costly and halfway around the world. While she does dream of owning a home one day, she is in no rush. One must wonder, how could she? With rent, student loans, and planned trips, it is difficult to put any money aside for a house.

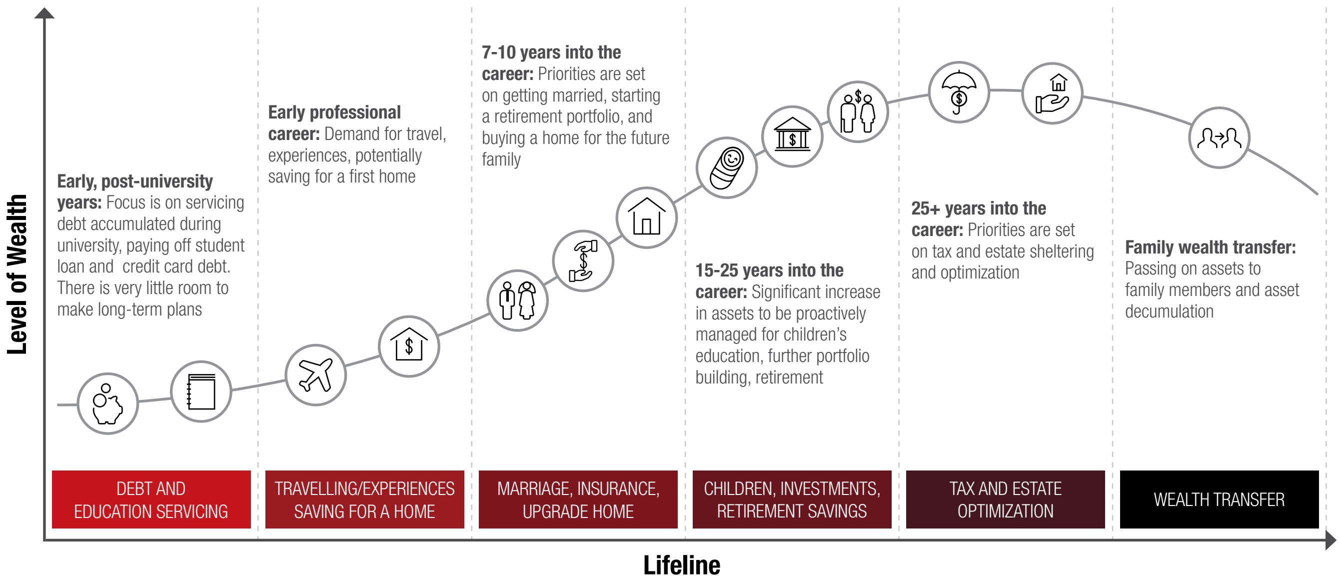
Jessica and Tom are expecting their second child. In their thirties, raising their small child preoccupies their time, and they have a goal of purchasing their first home. In addition to the daily pressures, they are also a single income household. Given the many key life events that are compressed in a short period of time, they need to sort out the cash outlay for their future home, put enough money aside for their children's future education, as well as worry about paying their monthly expenses. While Jessica was advised to get a life insurance policy after having their first child, she never got around to doing so. However, with the second child on the way, and given they operate on a single income, Jessica decided that they need to purchase a 20-year term life insurance to protect themselves from unforeseen events.

INTRODUCTION

The personas mentioned exemplify some of the common attributes that most investors have today. Investors want to see their assets grow over time to support the goals in their life. Historically, to achieve this growth, advisors have always attempted to beat market returns for their clients. The general measure of success has been to beat the related benchmarks and continue building the client's wealth. The focus was to lose less than the market when the markets yielded negative returns or grow faster than the market when the markets are growing. Beating the benchmark during bear and bull markets was the measure of success for the client and advisor.

Figure 1 – Goal Lifecycle

Throughout a person's lifetime, their goals and priorities will change as will their wealth. Individuals at an earlier stage in life are focused on reducing debt and have very limited investable assets. As they journey through life, their goals will change due to key life events and turning points as well as the growth of personal wealth.



While advisors should always listen to their clients' goals and objectives, portfolio and asset management did not always revolve around achieving goals. If it did, it was not done so with laser-focused precision. Whether the focus was on beating the markets or finding the right investment products for clients, fulfilling the client's life goals was not a central pillar. Goals were a part of the conversation, but not necessarily the centerpiece of it all. Even though the growth (or losses) of assets means that a client will either meet or miss their goals, the mindset for advisors and clients did not revolve around this important notion. In the past several years, the term 'goal-based planning' has become a prominent buzzword in the financial industry. It is a term that is easily understood by investors and carries a certain amount of meaning for investors. Goal-based planning needs to not only resonate with clients and meet their goals, but it also needs to be flexible and adaptable to market meltdowns and life-changing events. The unforeseen market shock that has recently occurred in Q1/Q2 of 2020 due to the COVID-19 pandemic will serve as a test for portfolios constructed leveraging goal-based planning methodology and tools. Given that the tools in the markets are new and advisors are starting to use these tools more, this crisis will validate the value of such an investment approach.

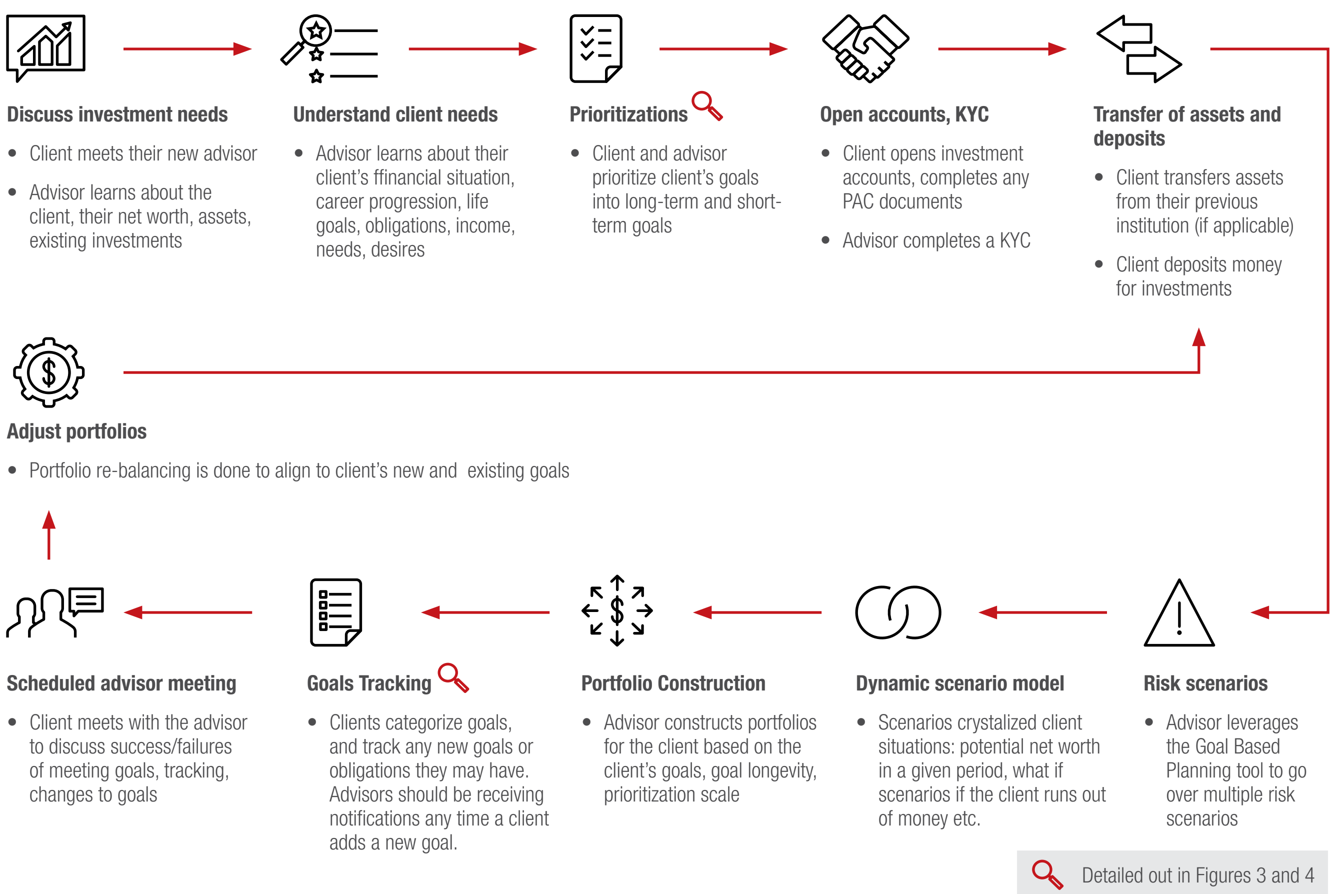
GOAL-BASED PLANNING EXPLAINED

What is goal-based planning, and why is it so intuitive for investors to easily grasp the term? Most of all, goal-based planning is very client-centric. It all starts with the investor. When it comes specifically to investing, the complete portfolio lifecycle focuses on the client in question. The advisor concentrates on portfolio construction and the management of the assets to match the client's risk profile, investment preferences, and in the end, the client's goals. A typical client will most likely have multiple goals.

Depending on what those goals are, the appetite for risk and returns will change. Therefore, each goal should have a portfolio. This specific portfolio should match the goal that the client is looking to achieve from a risk and reward trade-off. In the end, the same client might have a more conservative portfolio, or a more aggressive portfolio depending on what goal they are looking to achieve with those respective strategies.

Figure 2 – Goal Lifecycle

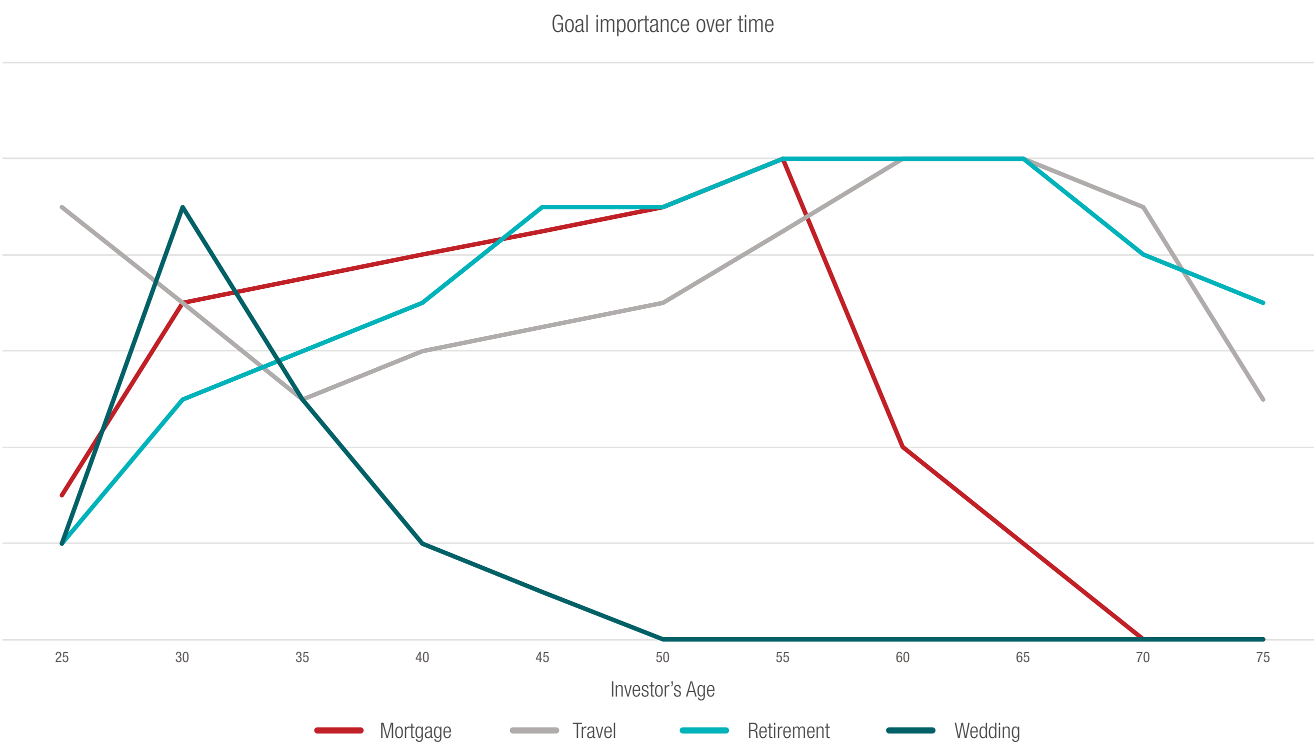
Goal-based planning process focuses on a client's goals, time-horizon for the goals as well as the goal prioritization. Rather than focusing on investment products and the client's risk tolerance, the advisor will focus on the client's goals and leverage goal-based planning tools to identify how those goals will be achieved with which investments.



The client's goals also revolve around the client's time horizon. The importance of each goal relative to other goals will change throughout a client's lifetime. Short-term goals may not be as aggressive or as risky as some of the longer-term goals. The goals will also account for a time factor. Therefore, investors leveraging advisors that use a goal-based planning tool should see their portfolios perform relatively well during market shocks (e.g., COVID-19 pandemic). While global markets are experiencing significant negative returns, portfolios based on enabling short-term goals should outperform the markets due to their more conservative nature due to a higher concentration of lower-risk financial instruments. With a smaller impact on their portfolios, the clients should be better off, given that they may need to access their capital in the short-term.

Figure 3 – Client's Goals Importance Over Time

An average client will have both short-term and long-term goals. The goals are adjustable, and the client's stage in life will drive their relative importance. The priority for each goal will change over time. The below graph illustrates how certain goals will decrease in importance over time while others will increase.



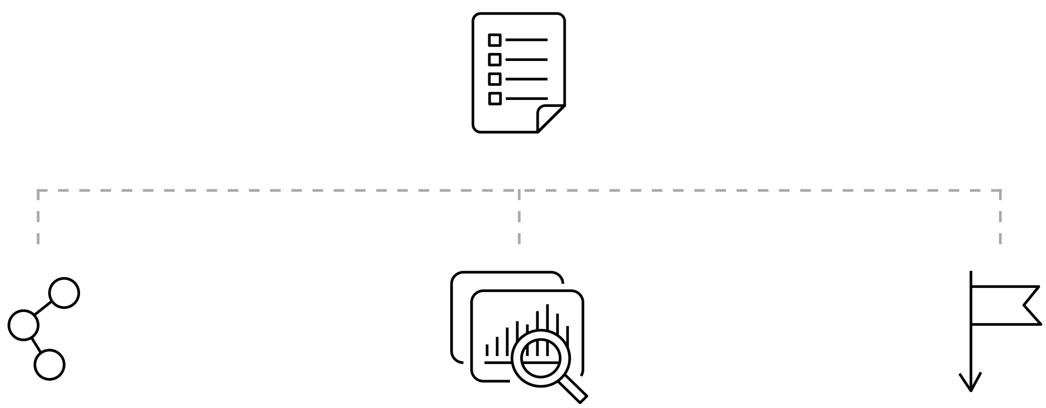
When an advisor frames a portfolio around the client's goals, the advisor has an opportunity to make things more personal for the investor. Inundating clients with complex financial terms will not make anything easier for the client. The average client will have some challenges grasping the information. This all, of course, truly depends on the client's financial literacy. On the other hand, conveying the information to clients in actionable plans, will allow the client to be more invested in their portfolio and the entire investment process. Quantifying the goals, and consistently revisiting the progress of portfolios will give the client more clarity on what they are achieving with each one of their portfolios. One key method to measure whether the client will be able to achieve their goals is their risk tolerance.

Risk in goal-based planning is measured by whether a client will be able to have the financial assets to meet their goals. Goal-based planning applies the portfolio management concept of asset-liability matching that has been traditionally used by financial institutions such as pension funds. Pension funds have used asset-liability matching to determine how much they will have to pay out to meet their pension obligations. In the case of goal-based planning, this comes down to individual clients where the client's financial goals are viewed as financial obligations and liabilities by the advisor.

This is not a one-time set-up of a client's goals, but rather an iterative process that needs to be reviewed and tracked to ensure that changes in the markets are in line with client's goals and to identify if the client's goals have changed. Goal tracking and progression become the focus of the advisor rather than the focus on maximizing risk-adjusted returns.

Figure 4 – Goal Tracking

An average client will have both short-term and long-term goals. The goals are adjustable, and the client's stage in life will drive their relative importance. As clients categorize and modify or amend their goals, the advisor should be notified.



Track individual goals

- Clients and advisors can track each of the client's goals
- Progress on each goal is visible to both the client and the advisor

Multi-layered client tracking dashboard

- Client can track their cash flow, expenses, inflows and outflows of cash
- In addition client can relate the cash activities and their impacts on their existing goals

Goal and milestone discussions with advisors

- Successful and not so successful goal tracking should prompt advisors to set-up meetings with the clients to discuss next steps in the portfolio

Clients rely on their advisors to help them track their progress towards meeting goals and identify if the client is at risk of being unable to achieve a goal due to unforeseen events such as a recession that impairs the value of their investments. Furthermore, goal-based planning means that advisors provide holistic advice that optimizes all the financial tools and resources available to the client, including insurance and employee benefits, to maximize the likelihood that the client's goals and desires are achieved.

Clients and advisors can leverage tools to track and analyze the client's cash flow and spending habits to identify insights and to monitor progress. Tools can also be used to help manage savings by moving excess cash into savings accounts that are assigned for specific goals. Furthermore, concepts such as gamification can be implemented by unlocking rewards if a client achieves a savings milestone.

THE RELEVANCE OF GOAL-BASED PLANNING

Goal-based planning is becoming more relevant because it is client-centric, more easily understood by the clients, and is a dynamic process that can be adjusted both due to external market factors, as well as idiosyncratic factors that affect a client's life

Irrespective of an investor's age, goal-based planning has a place in every investor's portfolio. Regardless of the client's wealth or stage in their life, each client will have goals they will want to achieve over their lifetime. While clients may have some common goals, goals will be driven by time horizon and risk. Hence, this is not so simple as each client will have different priorities at different stages of their life. It is important to note that all these goals are competing for the client's limited resources. Most of the time, goals are to be achieved from the same funding source.

As client needs become more complex, clients will also truly need more reassurance that they can meet the multiple financial obligations that they will encounter throughout their life. Retirement becomes especially interesting in western countries since, in recent history, defined benefit pensions in more developed countries are becoming a rarity and a luxurious benefit at the same time. Given the increase in the population's age, and a smaller number of companies providing pension plans, investors must turn to investing in the markets themselves or through their company's group plans. Hence another level of complex planning is added to existing goals.

Therefore, clients are beginning to demand more than what traditional financial planning provides, which is to maximize a client's portfolio returns given a level of risk, which is typically measured as the portfolio's standard deviation. Consequently, advisors need to move on to portfolio management methodologies such as goal-based financial planning, which can address the new needs of clients.

APPLYING GOAL-BASED PLANNING TO DIFFERENT CLIENT SEGMENTS

It is important to recognize that people of all wealth segments and life stages have goals. Individuals that are in the earlier stages of life or those in the mass market, in fact, have a lot of debt and few investable assets. Thus their short-to-mid-term goals are focused on reducing their debt. Goal-based planning leveraging tools such as cashflow management, spending analytics, or gamification will enable these individuals to achieve these goals. The traditional investment process is unsuited as it focuses purely on investing and asset accumulation and these clients are not a priority for traditional advisors due to the lack of assets.

A recent Vanguard survey of mass affluent and high net worth individuals identified that the top three services that they are planning to seek from an advisor are[1]:

1. Planning for long-term care
2. Creating an estate plan
3. Implementing tax-advantaged strategies

All three services are associated with anticipating and planning for future events and are a natural fit with the goal-based financial planning. Furthermore, the same Vanguard survey indicated that communication between the advisor and HNW client often trumps investment performance. Goal-based planning can foster increased communication between advisor and client as it is an iterative process that requires tracking of the client's ability to meet their future goals.

While mass market, mass affluent, and high net worth (HNW) individuals can benefit from goal-based planning, the method in which the advisor provides the solution can differ. Mass market and mass affluent segments will have less complex financial needs, and the focus will remain around clients maintaining positive cash flow and meeting liabilities regularly. HNW individuals require a more customized solution to account for their more complex investments and requirements, such as the implementation of complex tax strategies. To meet these various market segment needs, some firms decide to use off the shelf solutions, while others develop their own solutions. Number of firms offering goal-based investing tools is growing globally. In Canada, Manulife has become the first institution to offer liability-driven investment to retail investors, through their Manulife Securities advisors.[2]

The mass-market segment of the population has goals that they too desire to achieve but have some notable differences relative to the mass affluent and HNW segments. Individuals in the mass market segment have goals that are often smaller in dollar value and with a shorter time horizon. For example, an individual in the mass market segment might have a goal to take a vacation abroad next year and would require a savings strategy to fund the trip. In contrast, the mass affluent and HNW segments can fund these types of life events directly with their annual income and would not have to plan as rigorously.

1. https://www.vanguardcanada.ca/documents/spectrem-report.pdf
2. https://www.wealthprofessional.ca/news/industry-news/manulife-introduces-goals-based-investing-tool/248561

INDUSTRY SOLUTIONS

Creating a financial plan can be a trivial thing if you are focusing on one goal, such as retirement or education. But what happens when you start bringing in multiple goals at the same time? Suddenly that retirement plan is competing with other goals from the same funding pool. Retirement, education, emergencies, taking care of your parents, car payments, travel, and the list goes on. It becomes overwhelming for an investor to deal with all these things that are very important to them.

With the popularity of goal-based planning growing, the industry has seen new technology solutions offered in the market to meet this need. These solutions are supposed to help both advisors and investors formulate the goals together. Vendors in the market are seeking to deliver end-to-end solutions for advisors so that they can execute their plans fully for their clients. Some of the more common vendor capabilities include:

1. Identify and prioritize goals – visualize goal prioritization and evaluate trade-offs.

2. Determine the risk profile for each goal – perform risk assessments that consider both the client's risk preferences and the optimal timeline for goal achievement.

3. Deliver personalized investment strategies – align the client's target allocation to the best model and then customize the securities and weights needed to achieve the goal.

4. Create a goal-based plan in minutes – get actionable plans efficiently in a short time span.

5. Model realistic scenarios to demonstrate impact – leverage existing Morningstar research, data and analysis to model scenarios and make better decisions.

6. Move clients from plan to action – help clients understand the link between the investments and goals.

Furthermore, how technology solutions are implemented, and leveraged will also depend on the market segment that is being addressed. The mass market and mass affluent segments will leverage a higher proportion of direct to client technology interaction versus human advisor interaction. In contrast, high net worth segments will have advisors using goal-based planning tools during their meetings with clients.

While these capabilities are by no means exhaustive, we expect to see more and more incumbents and new market entrants providing powerful tools and solutions for both advisors and clients. We see the competition amongst vendors becoming more intense, with the vendors that are ahead of the curve developing more creative solutions for both advisors and clients.

CONCLUSION

As mentioned in the introduction of this paper, goal-based planning re-focuses and structures the conversation between the advisor and client in a way that is meaningful and engaging to the client. Furthermore, because goals are tangible and measurable, a client can identify if their advisor has helped them to achieve any of their specific goals. Modeling the impacts of systematic and market risks should tie into outcomes. The COVID-19 global pandemic should be a great litmus test for not just the portfolio reaction to the crisis in the markets caused by the virus, but also to the shift in goals and their weight. For example, is that car that the client wanted to purchase as important in a scenario such as this, or should the client be looking to reduce debt and save more cash? If an advisor can build a flexible plan that will clarify for the client how their goals should change given various market scenarios, this should further help to build and strengthen the relationship between the client and advisor. Goal-based planning's iterative nature also means that the conversations and planning between the advisor and client is a never-ending process, and as goals are achieved, the client/advisor relationship is strengthened. This helps to make an enduring relationship between clients and advisors. As a result, clients and advisors stand to benefit from the adoption of goal-based planning. Clients can achieve meaningful life goals, and advisors can create stronger relationships with their clients. Given many positive aspects of goal-based planning, what kind of implications are in place for wealth management firms and their advisors?

Since clients have an abundance of investment choices: traditional advice, discount brokers, robo-advisors, the clients will take their business elsewhere if they are unhappy with the advice they are receiving from their advisor. Wealth management firms have an opportunity to have a mind-shift in their firms, invest in a market solution, or partner with a fintech company to develop a goal-based solution of their own. Building an effective goal-based planning solution requires a clear vision and strategy that will fulfill clients' desired investment goals. It also requires structured training and change management for the advisors. Wealth management firms should explore different options and seek to integrate available solutions with their existing technologies.

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ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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