



TAX ALPHA: DIFFERENTIATING YOUR PRACTICE IN A **MORE COMPLEX** & COMPETITIVE WORLD



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INTRODUCTION

Orion Advisor Services, LLC (“Orion”) is pleased to provide industry content based on the latest research, industry trends and expert opinions to help advisors succeed.

It’s no secret that massive change is happening in the wealth management industry – ranging from ongoing regulatory shifts to new technologies bringing a new type of low cost competition, to evolving demographics and shifting consumer expectations. All of these mega trends point to an industry in flux, one in which the stakes for having the right strategy is becoming higher and higher.

As a result, advisors, independent broker-dealers and their executives need to re-think their approach to building a sustainable wealth management business that has a flexible infrastructure with the latest technologies so that firms can adapt to these macro changes hitting the industry, else become marginalized in the future.

Chief among these trends are new competitive challenges in the form of bundled technology/human advice offerings from discount brokers and online robo advisors. These digital platforms and hybrid online-human advisor offerings are commoditizing investment and financial planning advice, driving basis points lower and lower. The result of which will threaten the profitability and long-term sustainability of the traditional advisory model. While these new offerings’ market shares

are tiny on a relative basis currently, the disruption these new models portend will be substantial, industry experts agree.

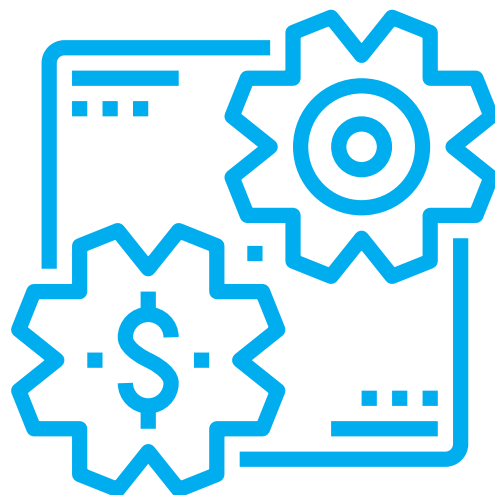
Many of these online and discount platforms are now advertising advanced functionality, such as tax efficiencies through their ability to automate daily tax loss harvesting, further raising the stakes for human advisors whose historical systems do not easily enable them to communicate this type of value added approach. Particularly in a world where investment management is rapidly becoming commoditized, advisors need to be able to communicate their differences.

The upshot? Now more than ever, advisors will need to demonstrate the value they provide to clients, differentiate their businesses and find cost savings wherever they can.

One key area that clearly shows the professional advisor difference is in providing superior investment management services by providing “tax alpha” through strategic trading and rebalancing.

For most advisors, however, they do not have a scalable way to deliver these customized investment services and are in need of a solution. For too many firms, these processes are manual, spread sheet dependent, provide little customization and result in scalability limitations.

To help firms think through their response to embracing this change, this white paper will provide a vision for what a sophisticated, scalable, tax efficient, trading platform can be, as well as provide guidance for using technology to truly differentiate your firm and maintain premium pricing in an increasingly digital world.



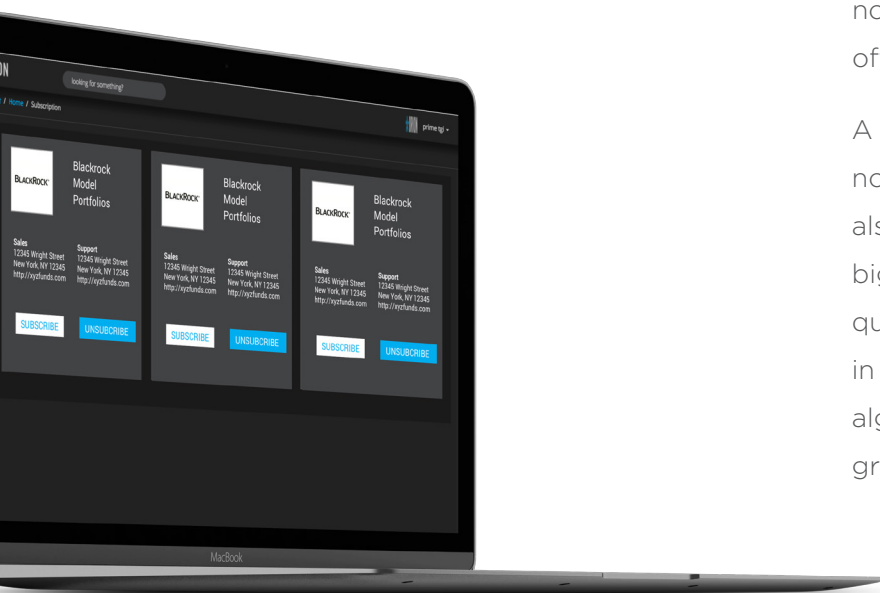
CHAPTER 1

Industry Trends

After decades of “easy” industry growth in which independent advisors have thrived, the world is changing – and a much more rocky road is ahead.

The latest research from Price Metrix¹, a subsidiary of global consulting giant McKinsey, & Co., shows that “firms are struggling with a drop in fees, a scarcity of new clients and little prospect of growth.” According to the research authors, “The current environment is one that is really challenging. There’s obviously a dynamic in the industry that’s challenging advisers and their value right now,” notes Patrick Kennedy, chief customer officer at PriceMetrix².

A key source of this disruption is originating not only from “robo” advice offerings, but also from new hybrid service models from the big online consumer brands that are evolving quickly and are pivoting to add human advice in combination with their automated investing algorithms. As a result, digital advice is growing quickly.



¹ <https://www.bloomberg.com/news/articles/2017-06-28/wealth-management-industry-hit-by-lower-fees-fewer-new-clients>

² <https://www.bloomberg.com/news/articles/2017-06-28/wealth-management-industry-hit-by-lower-fees-fewer-new-clients>

To illustrate how fast things are changing, we are now experiencing what many in the industry are calling the, “Great Robo Pivot,” a strategic response from the digital platforms to include humans as a component of their advice delivery. The direct to consumer robos are beginning to struggle with their growth and sustainability as a strictly online model, as average account sizes are declining and their bare bones pricing is putting added pressures on their profitability. Competitively, the big online discounters including Vanguard are also joining the robo party, further putting pressure on their business models.

In response, now virtually all of the original robo platforms and the discounters are rapidly moving to include humans in their offering in order to appeal to a wider audience. As a result, this hybrid movement is becoming a very strong alternative to traditional advisors, at a much lower cost despite the inclusion of the personal, human touch.

Even the digital only robos are expanding their offerings. Online pioneer, Wealthfront is aggressively promoting its financial planning tools as well as tax loss harvesting abilities, widely advertising: “*Automated daily tax-loss harvesting at no additional cost to all clients*”⁴.

As a result, providing investment management and planning services is becoming a more

TOP 5 ROBO PLATFORMS AND THEIR ASSETS³:

VANGUARD
\$83 BILLION

SCHWAB
\$19.4 BILLION

BETTERMENT
\$10 BILLION

WEALTHFRONT
\$7.4 BILLION

PERSONAL CAPITAL
\$4.9 BILLION

transparent and competitive world for advisors. Independent firms that once touted investment management capabilities as a differentiator, now need to up their game as it is clear that even the most basic of robo platforms can now do automated, tax efficient rebalancing, along with financial planning for a quarter of the cost of traditional advisors.

³ <https://www.financial-planning.com/news/who-will-win-the-robo-advisor-ipo-race>; <https://www.financial-planning.com/news/vanguards-robo-tops-100-billion> ; <http://www.thinkadvisor.com/2017/07/21/schwabs-robo-related-assets-surge-to-194b-in-q2>

⁴ <https://www.wealthfront.com/tax-loss-harvesting>

CHAPTER 2

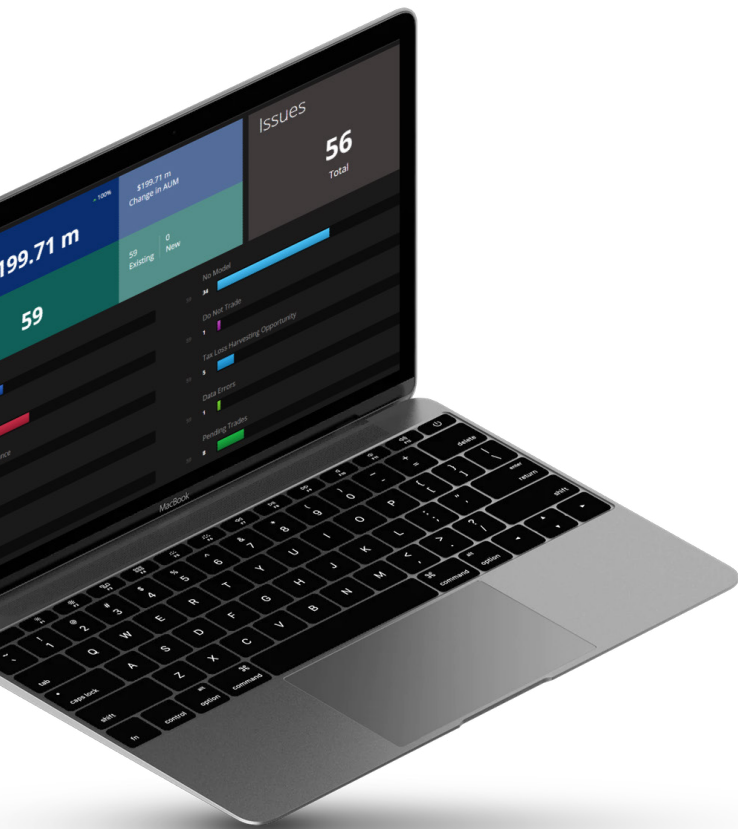
Tax Alpha to the Rescue

One area that is providing a lifeline to advisors in this new world order, however, is the ability to generate “tax alpha” for their clients.

As part of a seminal study on the value that financial advisors provide, Vanguard identified roughly a 3% “Advisor Alpha” from the value added services and methods that advisors bring to their client relationships. Of that, approximately one third comes from tax savings⁵ and efficiencies that a regular focus on rebalancing, asset location management, and the ability to identify tax loss harvesting opportunities brings.

The added benefit that originates from professional financial advisors provides a direct impact on investor performance, not only providing justification for advisors’ premium fees, but is a powerful messaging and communication platform that differentiates advisors and illustrates their value.

Additionally, from the high net worth investor point of view, these investors tend to appreciate being able to minimize tax liability. While this is a very intuitive point, there is substantial evidence from research on investor



⁵ <http://www.cambridgewealthcounsel.com/wp-content/uploads/2015/03/Added-Value-of-Financial-Advisors.pdf> and <https://www.advisorperspectives.com/articles/2016/06/28/the-advisor-alpha-how-much-are-you-worth-to-clients>

behavior and preferences that minimizing tax costs increases demand for advisors. According to the latest research from Schwab Advisor Services, saving money on taxes is a top priority for what advisors can provide for their clients⁶.

Thus, in a much more competitive industry, in order for advisors to defend their 1% fees, advisors will need to up their game in providing investment management services in an un-commoditized way. According to the Orion Advisory Fee Benchmark⁷, the typical advisor continues to charge 1.07% fees, aggregated across all account sizes*. The trick then for most advisors, however, is being able to deliver un-commoditized investment services in a scalable way.

Managing portfolios in a tax efficient matter requires keeping track of and modeling multiple variables, which becomes an extremely complex process when householding, the usage of multiple custodians and tax rules such as wash sale requirements are also factored in. For many firms, this becomes a manual process, based on spreadsheets and added research due to the limited functionality of existing rebalancing technology and custodian provided tools.



* The Orion Advisory Fee Benchmark contains advisory fee data with respect to hundreds of firms that bill their advisory fees through the Orion system. Orion's customer base consists of over 1,000 firms across the U.S. that maintain their advisory client data on the Orion system. While over 1,500,000 client accounts of varying account types, size, and investment strategies are maintained on the Orion system, Orion's customer base may not be entirely representative of the industry at large. Additionally, not all Orion customers may maintain fee data through the Orion system and such firms would be excluded from the results. The "average fee" reflects aggregated average fees billed directly by the Orion firm to households in the firm's database maintained on the Orion system.

⁶ <https://www.forbes.com/sites/charlesschwabadvisor/2016/12/05/5-things-financial-advisors-can-do-for-high-net-worth-investors-and-wealthy-families/#37575e8c3e15>

⁷ Orion Advisory Fee Benchmark Tool

CHAPTER 3

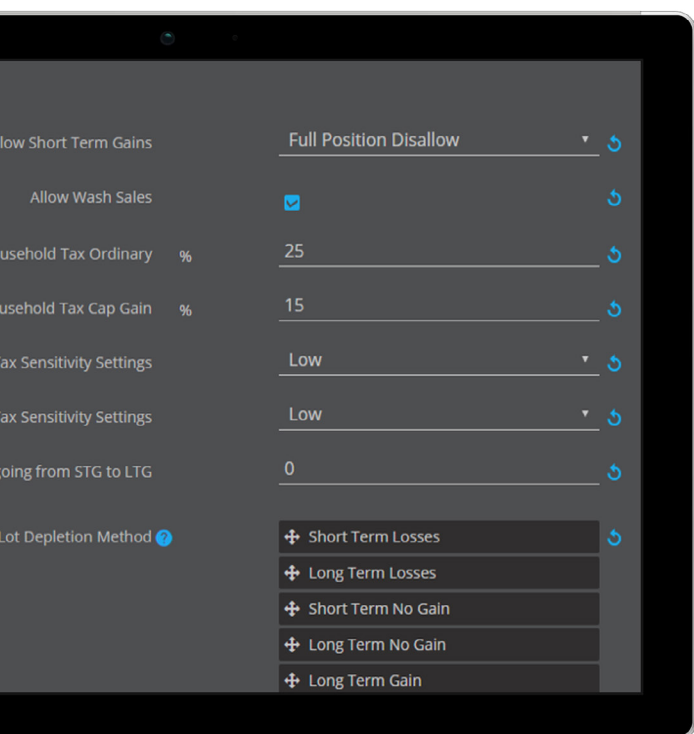
A Technology Vision for Scaling Tax Alpha

There are specific areas where advisors can deploy tax efficient trading strategies to generate tax alpha. These include, avoiding short-term capital gains and wash sales, optimally managing asset location between taxable and tax-free accounts, along with strategically managing lot depletion.

Each one of these areas brings in added complexity, stressing existing systems and limiting the frequency advisors can bring these strategies to bear.

What is needed is a tax loss harvesting, intelligence tool and trading platform to identify tax loss harvesting opportunities prior to entering trades, as well as the ability to identify positions with gains or losses in order to suggest an alternate product to buy in real time.

In order to provide tax efficient trading and take into consideration the many permutations inherent in this exercise, advisors need powerful and flexible trading and rebalancing technology. In order to achieve a “personalized” approach that goes above and



beyond account level to include householding, individual tax status, portfolio characteristics, asset classes, account types, asset location and other customizations is the holy grail.

By creating and controlling “sells,” advisors can better manage portfolio sensitivity from a tax point of view, enabling off, low, medium and high settings to sell positions that would be out of the normal model-driven portfolio management.

Also, by keeping track of carry-forward losses, maximum gains and other key information, advisors can truly deliver tax alpha. Without this type of automated technology and streamlined workflow capabilities, advisors can only rebalance infrequently, missing opportunities for their clients as their typical custodian supplied re-balancer doesn't have these capabilities and/or their own spreadsheet process doesn't scale.

In order to scale, trading and rebalancing systems need to harness advanced cloud-based technologies to provide the computational horsepower needed for a robust tax efficient rebalancing and trading technology resource, such as the Amazon Cloud.

These industrial strength platforms and systems can easily process via a Big Data approach the sophisticated calculations that can bring in multi-custodial data feeds, and leverage the scalability for real time integrations with the multiple systems involved.

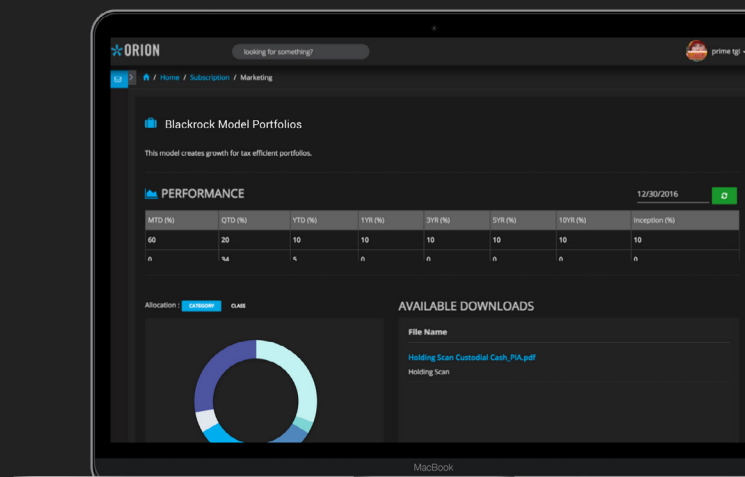
The result of this technology vision is personalized, tax efficient trading with tax settings that can be flexibly set at the firm, custodian, team, model, portfolio, household and account levels.

ENTER ECLIPSE

Eclipse is the next generation trading and rebalancing platform from Orion that brings the sophisticated ability to customize and automate trade and rebalance parameters, at the household, sleeve, asset category, asset location, sector and asset class levels.

ECLIPSE'S ADVANCED TECHNOLOGY ENABLES:

- **Automated workflows**
- **Cash management**
- **Trading Dashboards**
- **Oversight and approvals**
- **Compliance layer**
- **Fiduciary layer**



CHAPTER 4

Practice Management Benefits

Key to this technology vision is the benefits it provides not only to investment management, but also to client management, business development and operational efficiencies.

On the business development front, a tax alpha message can provide a compelling sales tool to generate and close new business. When reviewing a prospect's portfolio, advisors can use this advanced technology to illustrate and calculate the tax savings they can deliver through a strategic, tax alpha approach.

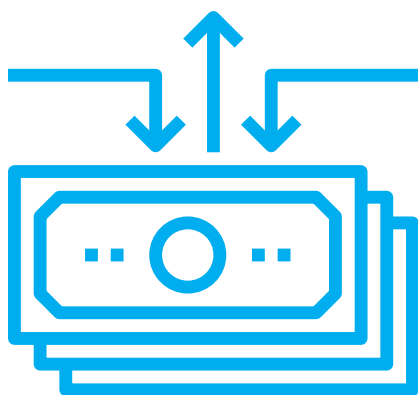
For example, if income oriented assets can be placed into qualified account types, while capital gain oriented assets can be invested into non qualified account types, the technology platform can estimate the tax savings for the client and then translate that into retirement income over a number of years.

This simple illustration not only showcases a more sophisticated approach advisors can deliver, but also communicates the advisor's knowledge of the power of asset location and how it can deliver a large, tangible benefit to the client.



Additionally, despite their claims, robo advisors are ultimately only facilitating a one size fits all approach, with no customization for the client. These simple platforms are not asking the key questions needed to personalize portfolios at scale for each of their thousands of accounts, nor are they keeping track of a client's holistic view – yet another communication benefit that this sophisticated trading and technology platform can deliver providing advisors a communication benefit in justifying their fees and differentiating their services from the robots.

The ability to deliver this level of trading and rebalancing flexibility via an independent system will provide the necessary scalability to increase advisor capacity, without adding new overhead. Automated workflows deliver not only lowered costs, but also reduce manual efforts, help eliminate errors and optimize client portfolios by being able to rebalance and tax loss harvest much more frequently.



CASE STUDIES

CLIENT PREFERENCES

- **Situation:** In a conservative allocation, suppose one client doesn't want to sell any position with a short-term gain, while others in that model do want to sell lots with short-term gains.
- **Solution:** Eclipse allows customization via automated exception processing with just a few clicks, while still enabling mass rebalancing of other portfolios to power efficiencies.

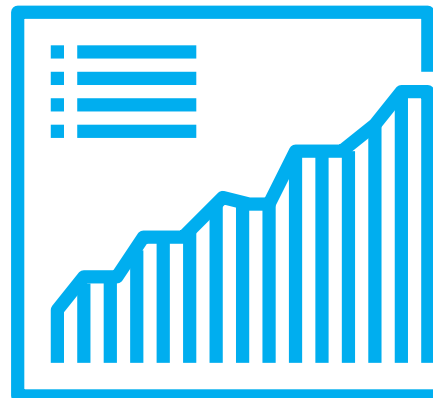
HOUSEHOLDING WITH ASSET LOCATION

- **Situation:** Rebalancing at a household level, based on preferences to which account type to buy or sell various asset classes for IRA, Roth IRA, or a taxable account.
- **Solution:** Eclipse allows customization via automated exception processing with just a few clicks at the firm level or for individual portfolios, delivering a scalable way to personalize portfolios.

CONCLUSION

It's no secret that the wealth management industry is undergoing a sea of change that is causing many participants to re-think their approaches, strategies and business models. Leading advisors are not staying on the sidelines as the playing field is being re-drawn by new technology-enabled competitors. These leading firms are deploying the latest advisor, purpose-built platforms to bring the needed efficiencies, scale and power to enhance their investment services.

By harnessing tax alpha, advisors are able to further differentiate their businesses and bring a tangible benefit that, combined with their personal service delivery, will continue to keep them ahead of the game. Now more than ever, advisors need to embrace and adopt advanced trading and rebalancing technology to build sustainable and scalable businesses that will not only help them survive the new environment but also take advantage of the many opportunities this industry evolution promises to provide.



ABOUT ORION

Orion Advisor Services, LLC (Orion) is the premier portfolio accounting service provider for advisors. Our firm has unique insights into the advisory profession because it was founded for investment advisors by an investment advisor in 1999. Orion frees advisors from back-office tedium so they can enjoy their business again by devoting their time and energy to better serving clients. Orion provides the integrated and fully customizable technology solutions that advisors need to help grow their businesses over the long term. The firm's technology solutions empower more than 1,100 firms, have \$500 billion in AUA and over 2 million accounts.

**DON'T WORK
WITH US YET?**
Let's change that.

Contact Us

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