What Investors Want Most in Investment Reporting

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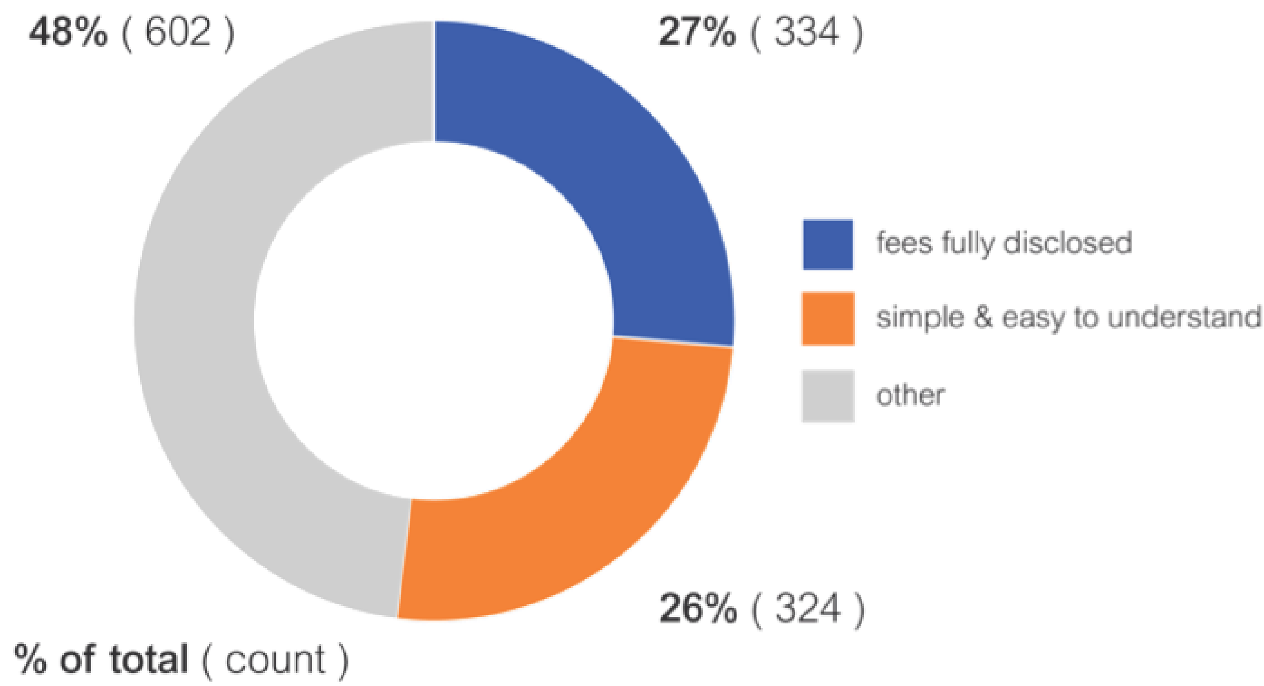
Trust is core to the relationship that financial professionals build with their clients, but certain issues that impact that relationship are out of the advisor's control. Performance reporting is clearly under your control, and our research shows what advisors need to do to respond to their clients' concerns.

For example, the advisor-client relationship is governed by "principal-agent" dynamics, where the agent is acting on the principal's behalf. Specifically, the advisor (agent) has a deep set of skills and expertise and implements financial decisions on behalf of the client (principal). Even though investors don't have high levels of sophistication when it comes to financial planning and investment management, they still need to determine whether their advisor is doing a good job. That's why investment reporting and financial-goal progress takes on such a central role within the relationship. It's one of the few ways that investors can monitor performance around a topic that is not their core area of expertise, and ensure that their agent is acting on their behalf.

The two highest priorities to investors when it comes to investment performance reporting are that fees are fully disclosed and reports are simple and easy to understand. That was a key finding in our research, as shown below:

Highest Priority in Investment Reports

"What is most important regarding your investment reports?"



Those were two of 15 different attributes from which investors could choose. To put things into perspective, the next five highest priorities combined were less than the individual weight that investors placed on these priorities.

For a financial advisor to leverage investment performance reporting as a cornerstone to improving trust and strengthening the relationship, then prominently disclosing fees and making sure information is presented in a way that is simple and easy to understand are clear first steps.

However, there's a deeper issue that impacts clients' perceptions of their investment reports. To investors, it appears that the financial advisor creates the information from investment reports. Industry insiders know that transactions can be aggregated at the broker-dealer level, and that third-party technology providers often perform investment metrics. But the "white-labeled" report that the client receives appears to come from the financial professional, along with all the calculations that the report entails.

In new research that we just published entitled The State of Investor Trust and Transparency, we set out to measure whether "information source" – i.e. that performance reports appeared to come from the agent in the relationship – impacted investors' level of trust regarding the accuracy and reliability of their investment reports.

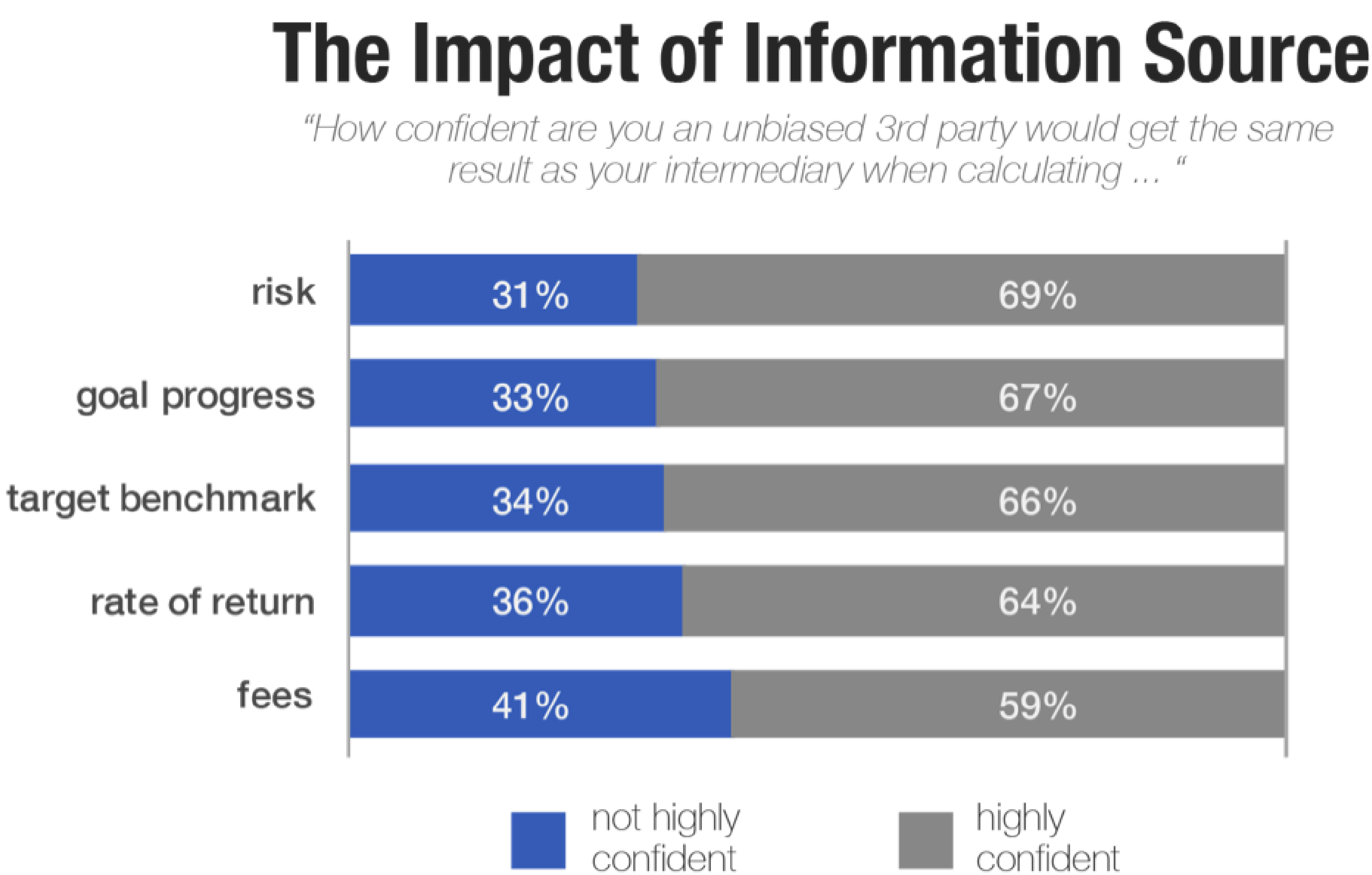
Specifically, investors were asked:

"If an unbiased 3rd party were to calculate your rate of return, how confident are you that they would get the same result as your financial advisor / 401(k) plan provider?"

In addition to rate of return, investors were also asked about their confidence in accuracy when compared to an unbiased third-party about the following metrics:

1. Fees
2. Target benchmark
3. Progress towards financial goal achievement
4. Risk

These metrics were chosen based on CFA Institute research[1] that found these metrics to be most important to investors. The following graphic shows, by reporting metric, the proportion of investors that were "not highly confident" that an unbiased third-party would get the same result as their financial advisor / 401(k) provider:



Source: Marketing/Investor Transparency Study/Articles/CFA Institute Article/nhc-by-metric.png)

The graphic above provides insight into how the source of information impacts investors' perceptions of accuracy, especially in light of the ubiquity of white-labeled reporting. The impact of this research on advisors is clear: investment performance reporting needs further augmentation to ensure investors of its accuracy. Taking the following steps can help maximize the confidence that investors have around their investment reporting:

- **Account for varying levels of financial literacy:** In our research investors had varying levels of financial literacy, regardless of net worth. Investors with lower levels of financial literacy were more likely to be "unsure" if the core aspects of investment reporting were provided to them. Therefore, take extra time with clients who have low levels of financial literacy to go over investment reports and the importance of the information it provides.
- **Explain the "white-labeling" and how performance metrics are generated:** Discuss how white labeling works and explain the source of the investment performance calculations. Clarifying that the reports are prepared by larger financial institutions whose core business is to generate investment reports reinforces that the source of the performance information is, in fact, not the advisor.
- **Work towards creating better investment reports:** The entire second portion of our research provided a framework to construct better investment reports, and the financial advisor needs to take an active role. By working with technology firms that prepare investment reports, while stressing the importance of ease of understanding and prominent fee disclosure, better investment reports will lead to greater trust by the investor.
- **Performance verification services:** Performance verification assures investors of information transparency. In our research, we polled investors and found that nearly 75% of investors would be interested in using a performance verification service if it was offered by their financial advisor.
- **Focus on better relationships with clients:** Lastly, financial advisors who are very likely to be recommended by their clients had lower proportions of investors who were "not highly confident" in performance information. By building stronger relationships with clients and maximizing their likelihood to refer you to other investors, advisors can reduce the skepticism that investors feel about performance information.

Although our research indicates that there's no way to completely eliminate investors' concerns about information bias provided by advisors, by taking the steps above financial advisors can minimize its impact and address some of the challenges that naturally arise within the context of a principal-agent relationship.

David M. Thompson is managing director of affluent practice and Phoenix Marketing International. He specializes in providing ongoing affluent and high net worth investor intelligence and insights to leading wealth and asset management firms worldwide. Central to his practice is the Phoenix Wealth & Affluent Monitor, a large-scale monthly research tracking platform targeting affluent &HNW investors in the United States and Canada.

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[1] CFA Institute. *From Trust to Loyalty: A Global Survey of What Investors Want*. 2016.