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Guest:	Michael Kitces, Financial Planner & Publisher, Nerd’s Eye View

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Intro

Welcome to The Next Frontier, where we examine what the role of the financial advisor will be in a world that's being disrupted by artificial intelligence and algorithms. Our mission is to spark new conversations that create stronger connections and build greater client confidence. Join us as we look at our industry and others through a new lens and explore the opportunities emerging at the intersection of high tech and high touch. It's time for a new conversation. Are you ready?

BILL COPPEL

Hi. This is Bill Coppel, and welcome to this episode of The Next Frontier. Today, I'm joined by Michael Kitces. You probably recognize the name from his popular financial planning blog called Nerd's Eye View and his tireless work as an industry thought leader. As an active writer and keynote speaker, Michael's work is frequently featured in The Wall Street Journal and Businessweek as well as on CNBC and the NBC Nightly News. To round out Michael's work in the financial community, he is the host of his own podcast, Financial Advisor Success, which serves up success stories and insights from the most successful financial advisors and leading industry consultants, all aimed at helping you take your business to the next level. In addition, Michael is a partner and director of wealth management for the Pinnacle Advisory Group. Michael, welcome to The Next Frontier.

MICHAEL KITCES

Thank you, Bill. Good to be here. I'm looking forward to the discussion today.

BILL COPPEL

Well, we're honored to have you with us. And I want to personally thank you for the dedication that you have given to the industry with the hard, tireless work, as I mentioned earlier, with the writing and the speaking and your thought leadership, because it's most appreciated.

MICHAEL KITCES

Oh, my pleasure.

BILL COPPEL

Again, it's really great to have you. I say this because, as you look out over the landscape, it's not getting any easier today for financial professionals. There's many competing headwinds, everything from an increasingly tightened regulatory environment to the impact that the digital tsunami is having on the way we live and interact. It's clearly changing our sentiments and expectations. It's really putting some challenges out there. So that kind of as a backdrop, my first question is, from where you sit, this aggregator of information and the insight you've gleaned from the hundreds of folks you've spoken to, your involvement in the industry, what is the state of the financial services space today?

MICHAEL KITCES

So as I view it, the financial services space is in a moment of flux. It's in a transition point, and I don't say that lightly. I mean, I think we always talk about the world is always changing and evolving, which it is. But as I look at sort of the era of the financial advisor, we really had three distinct eras of financial advisors giving advice and running and growing their businesses. So the first of the modern era is essentially the era of the stockbroker. Back in the 1970s, you could get paid as much as $200 a trade in 1975 dollars, which is pretty amazing today, to execute a stock trade. It was an incredibly lucrative business. Advisors could get their book of clients, which back then was literally a physical book of people you could call to sell stocks to. You can make an incredible living. And it had been that way in part because stock trading fees were actually fixed by the regulators back then to prevent price gouging.

MICHAEL KITCES

And it changed in 1975 when the SEC decided to deregulate trading commissions and allow them to float and allow competition to come in. And there was a tech disruption that happened almost immediately thereafter, this Northern California/San Francisco startup firm decided to use these newfangled things called computers to see if they could disrupt stock brokering and execute trades at a lower fee. You may have heard of them. They were called Chuck Schwab, started in 1975 right after the SEC changed the rules. And TD Ameritrade, predecessor to E*TRADE, and Scottrade all came in the years that followed, these tech startups that were designed to disrupt the human financial advisor/stockbroker. And the technology won. The cost to execute a stock trade fell by 90% in 20 years, and everybody stopped being a stockbroker. We all had to move on. We went through a technology-driven transition, and we became mutual fund people. We said, "Well, anybody can sell you a stock. I will help you find a good stock picker." It was a better value proposition. I would argue we added higher value to consumers, built some tremendous companies, many of whom are still around today.

MICHAEL KITCES

This was the birth of the independent broker-dealer movement because, of course, once you were selling third-party mutual funds and not your company's stocks from inventory, you didn't need to be a national or regional broker-dealer with your own investment banking division. So we had an incredible run doing the mutual fund business as financial advisors. And then, once again, technology showed up. Late 1990s, the internet showed up. All of a sudden, consumers could buy no-load funds themselves using technology, which was literally the thing we all got paid for as financial advisors distributed to consumers with a cost of zero. It was a complete dislocation and disintermediation of the financial advisor business model driven by technology. We're still seeing that play out today with the disruption of mutual funds. And it led to the birth of a new model where we said, "Well, anybody can sell you a mutual fund. I will create for you an asset-allocated, diversified portfolio." And we went into the asset allocation business, the fee-based business, the RAA model, advisory accounts, your different channels adopted in different ways. And that's the run we've had for the past 20 years.

MICHAEL KITCES

And so we've had these three distinct eras. There was the financial advisor as a stockbroker until technology disrupted it. Then there was the financial advisor as mutual fund salesperson until technology disrupted it. And then there was the financial advisor as asset allocator. And now technology is disrupting it again. It happens almost like clockwork every 20 years. The first change happened in 1975 with the birth of the discount brokerage movement. The second change happened in the mid-'90s with the birth of the online brokerage movement. And the third change happened in the mid-2015s or so with the rise of the robo-advisor. And so we keep going through these changes. And every single one creates a period of transition where a whole bunch of stuff changes, new business models get created, old business models begin to decline. But we always emerge from these with a higher value proposition, more successful, more robust financial advisor offering for consumers. It always gets better on the other side of these. But they are transition periods, and not everyone makes the transition successfully.

BILL COPPEL

So we're at a transition point. We're at an inflection point. We're probably approaching maybe the fourth, right, as a result of what's going on. What's interesting in your comment when you referenced that small West Coast firm that can be credited in some respects as being the first big disruptor, they're still at the front of the line.

MICHAEL KITCES

Yeah. Well, the interesting thing just about companies that innovate is companies that are good at being forward-looking innovators often manage to repeat it. Right? We see that with companies like Apple that, frankly, created three distinct, major tech disruptions all in the span of 10 years. First, they did it with the iPod and obliterated music players. And then they did it with the iPhone. Right? Remember the old days where the primary function of a phone was to call someone? Not anymore. And then they created tablets, these things between the smartphones we just got and the computers we already had that we didn't know we ever wanted until we got one, then we couldn't live without them. So companies that do this well often manage to do it repeatably.

MICHAEL KITCES

And I think to their credit, Schwab is a good example of this, that they were at the forefront of the discount brokerage movement and one of the first innovators of using technology to disrupt stock brokerage. They were at the front end of the online discount brokerage movement with the rise of Schwab.com. And frankly, they're at the front end of this movement as well. They've launched their robo-advisor platform, Schwab Intelligent Portfolios. The piece that's even less appreciated is they've also grown a very substantial private wealth division that has tens of billions of dollars. It is larger, frankly, than most of the RAA firms that they actually serve. It's built entirely internally. They are making this pivot once again, as they have several times successfully, because that's what innovative companies do. And at the same time, you always get a couple of new companies that arrive in these transitions as well as a couple of older players and incumbents that get knocked out.

BILL COPPEL

Okay. That's a great recap. So what happens now to the individual? As we've just pointed out-- as you've just pointed out, technology has played a major role through these three major transitions. And I would say the mention of that has been continuing to remove the value to a large degree of that intermediary or that financial professional. Right? A lot of it has been replaced by technology. In fact, today, with algorithms, artificial intelligence, and data analytics, I might suggest that that's a better platform to manage money, as we like to say in our business, than perhaps the intervention of a human being. That is a backdrop. Let's go forward. What's your prediction as to what the role of the individual person, the professional, is going to be in helping investors, helping people live better lives?

MICHAEL KITCES

Well, simply put, it means we have to actually start giving the financial advice holistically that we've talking about for the past 5 and 10 and 15 and 20 years. We've been talking about firms being holistic comprehensive financial planners and doing wealth management and giving broader advice, but the reality is that most of us don't. We give it to the extent of the portfolio. Right? And to be fair, that was a more holistic value proposition than the predecessor model, which was just selling one-off funds. Right? We don't do one-off funds now. We do a holistic portfolio that's fully asset allocated, aligned with your goals, aligned with the long-term objectives you're trying to accomplish. That's what made it the bigger and better value proposition that beat out the old one. But it's still very portfolio centric. And yeah, the problem at the end of the day is computers will do most of the portfolio stuff that we do now, the same way that computers do most of the mutual fund stuff we did 20 years ago, and the same way that computers do the stockbroker stuff we did 40 years ago.

MICHAEL KITCES

I think sometimes these advisors forget. There was a time where the entire value proposition of an advisor was identifying a great stock to buy, convincing people to purchase it, and then actually being responsible for order routing and execution and caring which brokerage firm on which exchange was going to execute it. And now technology has so automated that stuff that we take what literally was the foundational value proposition of an advisor of the past, and it's literally just a button click on a website now, like typing your trade, click a button, and just stuff happens, and the security show up in the client's account. It's so automatic now, we don't even think about it, much less realize that was literally the only thing we did for years and years and years in the past before technology changed that value proposition. And--

BILL COPPEL

I'd say to you that we were a gatekeeper. I mean, the reality was-- yeah, we called up with an idea, but they had no other place to go to get it.

MICHAEL KITCES

Right. It was forced distribution through stockbrokers, and your value proposition was your ability to gatekeeper better securities, get them better stuff that they couldn't buy anywhere else, execute it better at a superior price. And those aren't things we even largely talk about anymore because stock brokering became so completely driven by technology, it's just a couple of clicks on a website. And so what you'll ultimately find is a lot of what we do today with asset allocation slowly and steadily becomes the same thing. If I go back even just 20 years ago, when I was starting my career, I started right at the peak of the tech bubble. And when I was coming into the business in 2000, what all of my friends and peers were telling me was, paraphrased gently, "Michael, you're an idiot. Why would you become a financial advisor? We're all going to do this online. Anybody can make money day trading. It's so easy a baby can do it." Right? Because that was the commercial at the time, E*TRADE, with the baby day trading stocks from the crib. "Why would you become a financial advisor? Technology is going to automate and obliterate your business before you even get started."

MICHAEL KITCES

And what ended up happening? The internet, that thing that was supposed to obliterate the financial advisor business model 20 years ago, literally the thing we all use to run our businesses today. What was supposed to be our disruptor is the essential foundation we use to be efficient enough to add all the other value we add on top because the internet makes a whole bunch of things simplified down to a click of a button. And so when I look at the rise of robo-advisors, what I see is the technology we will all use in 5 to 10 years. That's how we'll manage portfolios. It will be down to a few clicks of a button. It won't be much more differentiated than what we can't differentiate much on today, like, "I've got special mutual funds." "Okay. So does everyone." "I can get you stock execution." "Okay. So does everyone." All those value propositions continue to fall to the wayside as technology marches inexorably forward. But all the time that you free up by not needing to do that, that's where you find the time to create the next value propositions on top, which to me are all about how do we really get into much more holistic financial advice, where we're not just talking about clients' portfolios and we're not even just talking about their balance sheet-- or their assets.

MICHAEL KITCES

We're talking about their whole balance sheet, so we're giving advice on mortgages, debt, credit cards, student loans, which we have no education for in the advisor world. But the reality is there's more money in student loans than there is paid out from social security every year. And we spend a huge amount of time studying social security and almost nothing studying student loans. It's about cash flow and spending advice and helping people actually figure out what to do with their money and how to spend it and how to align it with their values. Maybe if they're a little more affluent and have choices, how to just make better financial decisions. If they're on the lower end of the income spectrum, it's about advice in their careers because for most people who are still working, the single greatest thing we can do to help a client improve their financial situation has nothing to do with getting them better returns in their retirement account. It's about helping them get a better job so they make more money and can contribute exponentially more into their retirement account in the first place. And so the advice becomes more holistic because we will use the technology to increasingly expedite the process of all the investment stuff that we've done over the past couple of years.

BILL COPPEL

So it sounds to me like at the heart of this is we'd better start asking a very simple question of, what really matters to people? What you've laid out are things that take place in their lives. So let's talk about that transition you've just explained of those things that are important, for sure, but doesn't it start with really understanding what matters to a client? Because I would argue that if you really get to the heart of it, it's probably not their money. What's your [crosstalk]?

MICHAEL KITCES

Well, the money becomes an expression of how they're getting to their goals and outcomes. It's not the goal and outcome unto itself. But to me, frankly, we have broader structural changes in the industry that are slowing this change or making it harder for some advisors or some firms to make the transition. On the one hand, we still have business models that are largely attached to the traditional investment and assets under management model. And frankly, I think the discussion of the demise of the AUM model is grossly overexaggerated. It's a great way to deliver value in an investment portfolio. It's not a bad way to price holistic advice because you can just do a bunch of stuff for the aggregate fee. You might have to do more than you did in the past, but it doesn't necessarily break the AUM model. There's actually a bunch of powerful client psychology if you look at pricing research about why the AUM model works well.

MICHAEL KITCES

To me, its greatest constraint is simply it only works for about 5 or 10 percent of the population who has enough money to manage and is willing to hand it over to an advisor. So they've got an investable portfolio. It's available, it's liquid, and they're delegator oriented enough to hand it over to an advisor in order to get advice. And it ignores the other 90% of the population that might not have the liquid assets but easily has the income or net worth. Right? It's the business owner who could write you an advice check for 2 grand or 5 grand or 10 grand a year, but you will never get a portfolio from them because they have no liquid net worth. It's all in their business. And if they have a business liquidity event, they're just going to go make another business because that's what serial entrepreneurs do. So you're still not going to get the money. They're just going to plow it into the next business instead.

MICHAEL KITCES

And so they have a desperate need for advice, but we don't have a good model for them. Or it's the new doctor who's finished residency and started their medical career, and they're making $300,000 a year, but they have $200,000 in student loan debt. They're not going to be contributing to a portfolio for a decade because, first, they're going to pay down the debt. Then they're going to get married. Then they're going to pay for a marriage. Then they're going to pay for a house. Then they're going to start saving for kids' college. And then maybe at some point in the early 2030s, they'll finally start saving materially for a retirement account. But a doctor making $300,000 a year can pay you thousands of dollars a year in financial planning fees without thinking twice about it. It's a very modest piece of their income as long as you just charge them for the advice.

MICHAEL KITCES

So I think we are constrained in part by our business models, which make us often unintentionally focused too much on the portfolio. And it's not that we don't-- it's not that the portfolio doesn't need to be implemented. Right? Like a client has a pool of money. It needs to be implemented somewhere. But getting paid in the portfolio, I find, often makes us unduly focused on it and then struggle to help the client with the rest of their financial issues because we get caught up in this very reasonable mentality of, "I'm not actually really getting paid for all this other advice." Or maybe I'm giving it because it makes my client a little stickier, but it's not same incentive as actually being able to get paid for the advice. So I think we have both business model constraints and, frankly, educational constraints. We're not trained in all the rest of that holistic financial advice stuff. Still, if you look at the total advisor landscape, about 30% of them have CFP certification, not quite 30%, but we're getting close. So when two out of three advisors doesn't have a credential like that to have the training and education to give holistic advice, the starting point for a lot is just you may have to go back to school and up your game to be ready to have better, deeper conversations outside the portfolio to add value in the advice environments of the future.

BILL COPPEL

Well, what's interesting, Michael, is that what you're talking about here is-- and particularly when you talk about the CFP certification, and the steps there are clearly much more broad and deeper than what we ever learned to get a Series 7 license. But isn't there a soft side or a soft skill set that's associated with what you're talking about? I recall an interview you did with Saundra Davis, and she is really focused on this concept of financial coaching. And I want to kind of separate the two words for a minute. Let's put financial over on the side. Let's talk about coaching, because one of the things that I uncovered as I listened to her conversation was this was much less about the traditional yellow pad, copying down, asking the pointed questions about what someone has or what they want, and really beginning to move the conversation in a way that helps clients self-realize, self-actualize what matters. In fact, my interpretation of this conversation was really the skill here is for advisors to help clients ask better questions. That's not a course that typically you see in a traditional training program for a financial advisor today.

MICHAEL KITCES

No. And again, to me, it gets back to our business model challenges. Right? I started in the industry as a life insurance agent. I was trained to sell life insurance. I had a lot of training on product sale, on our product lineup. So I knew how the products worked, and I knew the technical details so I could explain it to a consumer that asked. I had some sales training, right, like how do I get them to sign on the dotted line, because I would like to get paid, and that was how I got paid. But I didn't learn or get taught about holistic financial advice, nor particularly did I need to, because at the end of the day, my outcomes were judged by my ability to get clients to implement a product. Even over my careers, the businesses evolved. We went from a product-centric model to a AUM model, which is what our advisory firm operates on today.

MICHAEL KITCES

And the AUM model, now we have to learn to be effective at delivering a little more holistic value so that we can make the case for why we need to manage the client's holistic portfolio. But we still have to be careful not to succumb to just focusing on asset gathering and portfolios, and adding value beyond that. And so we, frankly, haven't really set ourselves up for the kind of value proposition that coaching delivers, which at the end of the day is about, "Did the clients change their behavior in a way that gets them closer to the goals and the direction they're trying to move?" And that's just not how we're measured. I don't know a single advisory firm today that measures its client outcomes not by policies implemented or assets gathered, but by the percentage of the advisors' recommendations that were implemented within three months of recommending.

BILL COPPEL

There you go. I mean, that's--

MICHAEL KITCES

Because if you measured that, you would take a very different approach to a lot of what we do. And that I think is the direction ultimately that we're going because if you want to charge someone for advice, right-- if you think about this in the context of, say, a personal trainer, I don't keep my personal trainer because they sell me some good vitamin supplements, although I might take them as a part of my training regimen. At the end of the day, I keep my personal trainer because I get on the scale and I'm dropping weight, or I'm adding muscle mass, or I'm lifting more, or I'm accomplishing some measurable goal where I can see my outcomes improve, personally, over time. And--

BILL COPPEL I want to stop you because that's a great analogy, because in our business, we look at benchmarks. And we look at rates of return, and we look at performance, which have nothing to do with whether or not I, as an individual, when I reach a point where I'm professionally ready to transition-- we like to call it retirement here in this country, which is, as you know, a fallacy.

MICHAEL KITCES Yes. I prefer financial independence.

BILL COPPEL Or a life transition. Right? We do two things in life. We transition and we pivot. We don't stop. I mean, most people don't stop.

MICHAEL KITCES Indeed. Yep.

BILL COPPEL And so the idea here is-- and you brought this up earlier a few moments ago, which is this notion of, "Is it so much how much I've got, what my balance sheet says, or do I feel better today than I did yesterday about the transition I'm about to enter?" As one example of a life transition. Right? How do we measure that? And what is the benchmark or the arch that we need to start thinking about as an industry to get there?

MICHAEL KITCES Well, you start looking at things like asking clients about their self-assessed well-being. Right? When you look at coaching in other domains and those types of coaching interventions, those are the kinds of measures we use. Do you feel happier? Do you feel more financially self-confident? Let's list all of the actual lifestyle and financial changes you've made while we've been working together to demonstrate how you are achieving successful change through our relationship. They're fundamentally different measures. And again, I do want to emphasize, if you're working with someone who has some affluence, there will still be a portfolio out there. It will still have to be implemented somehow. And frankly, it will be benchmarked, and it should be benchmarked because the client's assessment of the portfolio and your services in the portfolio is, "Are you doing well relative to a benchmark?" I think that's still an incredibly fair and appropriate way for an investor to evaluate an investment management service. But ultimately, the value proposition we'll be delivering goes far beyond that. That becomes sort of a sidenote item, a necessary thing that has to get done, but it doesn't become the central focus. And frankly, the less it's the focus, the more it tends to become commoditized. That's why, once upon a time, we all focused on the quality of our trade execution, and now we barely even look at the trade confirms.

BILL COPPEL And you're raising an excellent point here because the question I've got for you next is, when you think about what it is to be a financial professional today and whatever is the fee that you're charging - and it likely is going to be AUM based because, as you've pointed out, that's seems to be the traditional model that's in place today - what percentage of that fee should be allocated to managing the money as opposed to achieving the life objectives, helping people meet those transitional challenges that they make, helping them define what it means to live a purposeful life? How much of that fee gets dedicated there when you can get good asset management for, I don't know, 10, 12, 15 basis points?

MICHAEL KITCES Yeah. Well, I think you answer your own question there. When we can get robo-style solutions or easy technology to implement portfolios for 40 bips, 30 bips, 20 bips, 10 or 15 bips sometimes, at least, in institutional platform contexts, that's the portion of your fee that's allocable to that work. Maybe there's another 10 or 15 or 20 basis points you can call oversight of that work. Right? We can sort of separate out the investment management implementation and the investment management monitoring and oversight which you absolutely have to do in advisory accounts. But that still leaves literally the majority of the fee that's left over as a function of the value you're providing on the financial planning side. And so, again, to me, that really leads to two dichotomies. You get a subset of advisors who manage portfolios and charge a holistic 1% fee, but increasingly have to do more to justify that fee. Right? They got to do more outside the portfolio to demonstrate a holistic value proposition because the portfolio portion keeps getting smaller. Or you get advisors that just start experimenting with different business models to just get paid on the financial planning side. One of the themes that I've been talking about more lately is that if you really want to see the whole financial planning landscape begin to shift, imagine for a moment instead of charging clients 1% of their assets, you charge them 1% of their income.

BILL COPPEL

Interesting.

MICHAEL KITCES

Or 1 to 2 percent. Right? Frankly, if you really look at the advisor space, most of us charge somewhere between 1 to 2 percent when you go all in on total fees, top to bottom. But what would it look like if you charged 1 or 2 percent of your client's income instead of 1 or 2 percent of your client's assets? Who can you work with now that maybe you couldn't work with before?

BILL COPPEL

Sure. Sure.

MICHAEL KITCES

What kinds of advice are you going to provide because now you're not allowed to provide any value in the portfolio because they may not have a portfolio? But if you're working with some reasonably affluent folks who have higher income as opposed to higher assets, you may be getting paid thousands of dollars a year, a very good, healthy financial planning fee. But what would you do if you were getting paid 1 or 2 percent of income instead of getting paid 1 or 2 percent of assets?

BILL COPPEL

So following along that idea, let's talk a little bit about XY Planning Network. Because based on what you-- because just what you said to me reminds me of the story you told earlier about the physician, the doctor, who could be making $200,000 or $300,000 a year but has the equal amount in debt, has great income but is not at the point where they're really accumulating much in assets. What was your thinking behind cofounding XY Planning Network with Alan Moore?

MICHAEL KITCES

So XY Planning Network, our goal was to do a version of this model that we're talking about. I've spent a lot of time both working with younger advisors - I founded FPA's NexGen group, oh gosh, almost 15 years ago - and have been involved with kind of young advisor groups throughout the first part of my career. Alan had as well. And there's always been a phenomenon amongst financial advisors, we tend to work with people like us, similar backgrounds and usually our own age plus or minus about 10 years. And it's just because that's who naturally relate with. Right? At the end of the day, people do business with people they know, like, and trust. And we tend to know, like, and trust people like us. And so it's just kind of natural for advisors. We tend to build business with people who are similar to us because we can have similar chitchat. Right? Before I had kids, I didn't really know how to relate to grandparents. Now that I'm a parent, I know how to talk to other parents. Right? It becomes part of the natural rapport that you formulate with clients.

MICHAEL KITCES

And so one of the big challenges that was coming up amongst young advisors is young advisors want to work with young clients. And young clients don't work in the AUM model that we're all adopting because they don't have assets to manage. It just literally doesn't work. And so the industry has been saying for years now, as Xers and then particularly millennials come in the workplace, "Oh, well, you can't serve young people profitably in financial planning." And Alan and I said, candidly, "We think that's BS. You can absolutely serve young people profitably, just not with an assets under management model." Because it is true they do not have piles of assets to manage, for the most part. But a lot of them have income. They have financial wherewithal to pay. You just have to charge them in a manner that fits for them.

MICHAEL KITCES

And so the model that we championed was what we call fee-for-service planning, so just charge fees for the service. And in particular, we advocated working with clients on a monthly retainer model, so charge clients $100 or $200 a month. Frankly, most young people spend more than that on their gym membership and their cell phone, so not an unaffordable fee at all for a huge swath of people. And now, all of a sudden, if you charged, let's say, just $200 a month, $200 a month is $2,400 a year. If you work with 100 clients where you're just giving them this holistic financial advice for $200 a month, $2,400 a year, you're $240,000 a year of revenue with clients that everybody has said, "You can't serve profitably." And you actually have almost no overhead costs because you're not going to need to pay platform fees. You're not necessarily going to have IRA custodian fees. You're not necessarily going to have broker-dealer fees. You're just charging financial planning fees. It's actually a really simple RAA to set up. And suddenly you're making hundreds of thousands of dollars working with young people that everybody else said you can't work with.

MICHAEL KITCES

And so we created XY Planning Network to help advisors do that. So we are a support platform for independent advisors. We give them the technology they need, the compliance consulting. We help them set up their RAAs and do the registration and deal with the ongoing compliance updates and audits and all the things that go with it. We give them CRM financial planning software, payment software, because if you're going to charge clients planning fees, you need to actually have a payment system to do that. So we built one called AdvicePay. That's both for XYPN members and the general advisor community in order to do that. And then we give them business model and tools and templates about how to execute this model. And it works.

MICHAEL KITCES

So in about four and a half years, we've grown to just shy of 850 financial advisors. So you can think of us as the size of about a top-35 broker-dealer, but we don't do the broker-dealer part because there's no products because all the advisors are simply doing fee-for-service financial planning advice. And frankly, because it's such an underserved marketplace, we're finding the advisors are growing incredibly fast. We have a barely 6% failure rate for advisors who don't succeed in the model, when, as you know, the industry usually loses 70% of new advisors in the first three years. And we're losing about 6% because there's such a demand and there's such an opportunity for getting paid to give financial advice for young people. It has nothing to do with portfolios. It has nothing to do with products. It's answering all the other financial questions you have in your 20s, 30s, and 40s.

BILL COPPEL

And it has nothing to do with selling.

MICHAEL KITCES

Well, yes and no. It has nothing to do with selling inasmuch as it has nothing to do with our industry's traditional products.

BILL COPPEL

That's right.

MICHAEL KITCES

Frankly, the biggest challenge that I've long seen for the RA advisors, in general, and particularly a lot of fee-for-service advisors, you do still have to sell. You have to sell yourself. I mean--

BILL COPPEL

[crosstalk].

MICHAEL KITCES

--you still have sell someone on being willing to write a check for a nontrivial amount of money. It's easy to pay commissions on the back end. It's relatively easy to pay an AUM fee. Writing checks hurts. So you have to sell yourself and your value proposition. And the biggest challenge that we actually see for advisors that come in and try to do this model is it's the ones who kind of forgot that there is still some selling that goes on. I know selling has taken on kind of a bad and negative tone in our industry these days. And frankly, in society, there's kind of a stigma on selling. But even as a professional, you still have to sell. You're selling yourself and your value, maybe not a third-party company's products, but you still have to be able to convince someone to sign. Even if it's not sign to buy this product, it's sign my financial planning agreement.

BILL COPPEL

Well, that's just it. What I'm talking about here is a lot of us were trying to sell a product. Now it's about developing relationships and selling the notion of trust. And I agree with you. I think that the word selling is the misnomer in the sense that it's not connected to a particular product or thing, but rather building the confidence between you and that individual or prospective client. Because I would argue that the one thing people still need that Steve Jobs was never able to create directly with the iPhone is that human interaction has tremendous value. And I think, as an industry, we're not recognizing how powerful that is today. And I think you've done a wonderful job of showing that. Let me ask this question. Right. I love the XY concept, and it sounds like it's very successful. But what about the 55-year-old advisor? I mean, there's quite a-- I mean, if you look at the numbers, one of the fastest-growing segments of our industry today is this movement to fee-only. How do we translate what you've done with XY to someone who's been in the business for 25 or 30 years, maybe in their mid-50s, sees themselves not at the end of their career but perhaps beginning a new dimension or transitioning to a new career? What are the kind of skills and mindset that you'd recommend they adopt to behave more like your XY Planning Network than perhaps a traditional approach?

MICHAEL KITCES

Well, so a few things here. The first is, I think, really, if you're an advisor in your 50s or even in your 60s-- because you could still have a good long time horizon. I mean, a lot of advisors go pretty long in their careers in advising. This is not manual labor. The first question really is just do you actually want to do the change and deal with this change? One of the things that I think has become grossly overstated in the industry-- even as we're a firm that is-- with XY Planning Network, we are a firm that's rapidly growing and new and, frankly, kind of a disruptive business model to the traditional industry. But we'll be at 1,000 advisors sometime in 2019. There are 300,000 in total, and there are upwards of 300 million Americans. So there's plenty of room for everybody to succeed for a really long time. And one of the things I think, frankly, has been really overstated in the industry transition is how much danger the AUM model is in or really how much danger I think the AUM model is not in.

MICHAEL KITCES

Frankly, the beginning of the end of the mutual fund model was the late 1990s when the dot-com showed up, and it's only just the past few years that mutual funds are finally seeing net outflows from 15-plus years of [compounding?]. So even if we are seeing what ultimately is the beginning of the end of the AUM model, it's still going to be profitable for a very, very long time. And so if you're in your 50s or even into your 60s and you've got a 10-year time horizon, frankly, you can ride it out. You'll probably see growth slow down. You may see attrition pick up a tiny bit. But we form deep relationship with clients. Clients generally don't like to be disrupted or disrupt themselves and go through a whole bunch of change. That's why they're so sticky and we all have these 90-plus percent retention rates. Your clients aren't going anywhere, and you can ride this out if you want. You're not going to see much growth, but you can ride out what often is a very, very profitable practice, particularly by the time you get to that stage in your career.

MICHAEL KITCES So to me, the first question is just, "Do you actually want to make this transition and reinvent or not?" And I think a lot of advisors are simply going to hold on to their businesses, enjoy them profitably, and let them wind down very gently over time while earning a pretty darn good living for the stuff that they built so far. Now, for the advisors that have another leg in-- right? They want to do one more full stint. They want to do one more full growth cycle. They want to step up to the transition that's coming. Because frankly, I think it's an incredible opportunity. Right? If you look today, the first movers to the RAA space are the ones that are all billion-plus-dollar firms today, 15 and 20 years later. And the first movers into the independent broker-dealer space who eschewed the old stockbroker model are the mega companies today, like LPL, that have been around for 30 and 40 years. These transitions create huge opportunities for the people that make the transitions successfully.

MICHAEL KITCES But the essence of it is really taking a hard look at what value can you provide or are you providing outside of what you do in the portfolios. And the way that I encourage advisors to think about this is, "Look. As I've said, I don't think the AUM model is dying anytime soon. It's pretty sticky for a whole lot of reasons. But pretend for a moment that you're going to do financial planning for clients and you are not allowed to charge anything for the portfolio. You're not allowed to even touch their assets. You can't do that part. Now, I want you to figure out what are going to do for that client to earn the fees you do today when you're not allowed to touch the portfolio. And when you can justify that value proposition, go ahead and bring the portfolio on back in and do that as well. It's a great service, nothing wrong with it. But you have to force yourself to think about, 'What would the value proposition look like if I wasn't allowed to touch the money?' Because while you will be able to touch the money in the future, as we're saying, it's not going to be the central value proposition any more than picking a one-off mutual fund is in the value proposition. And selling an individual stock certainly isn't the value proposition anymore."

BILL COPPEL Okay. So that's an interesting position to take. I guess what I'm concerned about as an advisor, say, in my early 60s, my clients are dying. And every time one of my clients dies, I lose assets. Is there an opportunity, Michael, from your perspective, as you look at the 55- or 60-year-old advisor, to adopt some of the behaviors that you've developed in XY, particularly against that next generation? One of the things the industry has been really struggling with-- because it's been at, a large degree, net outflows to other organizations like Schwab, where we fail to connect across generations. With XY, you started in the middle, if you will, and you're managing up to the boomer generation and down to the Gen Zs, if you will. At 55, that's still quite possible. And while I agree with the fact that I could sit back and allow the annuity to continue to come in, if you will, that could dry up quicker than what we think. What do you think about how that 55- or 60-year-old person can start to bridge that gap by reaching deeper into the next generation down, leveraging some of the skills that you have developed through XY Planning?

MICHAEL KITCES Well, so I'll be a little controversial here and say that I think advisors who are working with retirees who are trying to go after next generation clients are engaging in a terrible business strategy, and let me explain why. So imagine for a moment you run a nursing home, a really high-end, high-quality nursing home, like the kinds of places that don't just charge 3 or 5 grand a month. You're one of those that charges $10,000 a month. You are a high-end nursing home. Now, that can be an incredibly lucrative business, particularly if you've got a good brand, if you're in an affluent community that has a lot of people who can pay $10,000-plus a month to be in your nursing home. But obviously, a nursing has a rather fundamental problem. Your patients keep dying because that's what happens when you run a nursing home.

MICHAEL KITCES

So as a nursing home who runs a very profitable business with affluent people but has a lot of turnover due to death, you have one of two choices. Option one, "Let's make the nursing home more tech savvy, bring in a bunch of iPads, put in a bunch of cool tech, and then we'll call the grandchildren who inherit their grandparents' money and say, 'Hey, since you've got money and you can afford $10,000 a month, you should come live in your grandfather's room.'" It's a nursing home! No 25-year-old wants to move in just because they can afford it, and it doesn't matter how tech savvy you try to make it. It's a nursing home. Millennials aren't moving in. If you have this problem as a nursing home, the optimal strategy is find more old people who are sick and need a nursing home who have the money to afford your services. You don't go after the grandchildren of the people who happen to be inheriting the money that paid for the old nursing home room and hope the millennials move in. Just find more old people who have money and need help. The good news is there are still 10,000 baby boomers turning 62 every day. That well is not drying up anytime soon.

MICHAEL KITCES

And so for advisors that are trying to figure out like, "I've got this retirement client base, but they keep passing away. What should I do?" What I would do is figure out how to get better at retirees, not chase the money down the line and pretend that your retirement-centric old people's practice is going to be appealing for a young person just because they inherited the money and you added a little bit of technology on [the doors?]. It's just not realistic. But there's an incredible opportunity to just actually get better with retirees. Right? If we take that same approach like, "What would you do for a retiree if you were going to charge all the fees you charge today and you're not allowed to touch their portfolio? What would you give them advice on?" Well, now, suddenly I'm going to be an expert on social security. I'm going to be an expert on Medicare. I'm going to be an expert on annual Medicare Part D prescription drug renewals, because if want to look at what really gets a retiree pissed off, it's watching their drug prices get jacked up every year.

MICHAEL KITCES

So I'm going to review their Medicare Part D prescription drug plans every single year. I'm going to become an expert in all of the nursing homes and continuing care retirement communities in the area. I'm going to build relationships with people who do home modifications for my clients who want to age in place in the homes that they're in right now. And I'm going to continue to go down the road of providing greatly enriched services that make me a better advisor for retirees than all the other retirement-oriented advisors that are out there because there's still 10,000 baby boomers a day turning 62 who are in search of retirement advice. And if it's what I'm already focused on with my clients, everything that I do to get better at retirement not only helps every new client I want to get, it also helps every existing client I've got to make sure that they stick with me and don't go anywhere.

MICHAEL KITCES

So this whole phenomenon of, "Let's try to chase the money down the family tree and get the kids when the original person passes away--" look, there's a subset of advisors that are truly in the ultra-high net worth space. They are genuine family offices. The entire family is truly the client, and they will work with multigenerational wealth. But for the rest of us, at the end of day, when you say, "My client had a couple million dollars and he passed away, so I'm going to try to keep managing the pot of money for the kids who inherit it," what you're really saying is your client isn't the client. What you're saying is, "The client is the pot of money, and I'm just going to go chase the pot of money, whoever happens to be the owner of it." And that's not client-centric advice. That's portfolio-centric advice. If you want client-centric advice, figure out how to be more awesome at retirees. There's no shortage of opportunities and a lot of ways that we can add value outside of just the retirement portfolio to be even more awesome at retirees.

BILL COPPEL

Well, I'll bet that, number one, that's very insightful. I think that's great, and I hope our listeners appreciate that point of view. The reality is that you're right, A, and B, caregiving is the fastest-growing concern in this country. And from an expert on caregiving, the number of referrals you're going to get, as you point out, will be astonishing.

MICHAEL KITCES

Oh, yes.

BILL COPPEL

You'll change the dimension of the relationship you have with a client, and they'll view you far more than simply managing their money, which means the client is likely to be very happy. And generally happy clients don't keep that secret to themselves. They tell their friends who are retirees, and they tell their children and their grandchildren. So the unintended consequence may, in fact, work out even better for that advisor who adopts what you're saying because, now, a lot of the things you talked about relative to what's important to people that are in the distribution phase of their life as opposed to retirement [inaudible]-- most "retirees" that I know view themselves as being in the distribution phase. Most feel like they're 35, right, hopefully. But what you're talking about are a different set of skills that we have to adopt as professionals in the industry, a different set of knowledge verticals that we have to penetrate and learn. And it's hard, as you point out [crosstalk]--

MICHAEL KITCES

It's hard. You have to make a decision that you're going to reinvest in yourself, your business model, your knowledge, your skill sets. That's the good and bad when change happens around the world and an industry evolves. For the people who want to make the transition, it is a phenomenal opportunity. But it's also a bunch of work, which is why I always start with that question of, "Do you want to go through the change and the pain that goes with that and the opportunity that comes on the other side?" Right? As always, where there is some risk, there is some reward opportunity. Or are you going to decide to ride it out where you are? If you're in your 60s, frankly, if you're in your 50s, you may be able to ride it out okay. You'll see some attrition. Clients will be in distribution, but they only leave so fast. They only pass away so fast. You'll probably retire before most of your clients go away. But if you've got a longer time horizon - you're in your 50s, but you're ready to do this until your 70s or 80s, which I know a lot of advisors are - or you're an advisor in your 40s or younger and you got a longer time horizon, this is your reality that's coming. And so you can either start making the transition now or let the transition happen to you, but the transition is happening just as the other three cycles have.

BILL COPPEL

What's interesting also about this, Michael, I think, is a very important point that you're making, which is you begin to redefine how you, as a profession, measure your own success and the value you create. You're actually developing a different set of measures for the purpose-- because one of the challenges we face, as we stay in this business longer and we age up in this business, is there's a lot of burnout in our business. Right? There's a lot of folks that really just get tired of it. But when you're able to go out and make a meaningful change in someone's life that exceeds the rate of return, where you can actually make their life better through those topics you just shared with the audience here, around those things that are really important-- when's the right time for someone to give up their keys to their car? That's a decision they have to make. That's not a decision that their children should be making. Helping clients accept and make the decisions that they have to, as they age up in their own lives, becomes a very different outcome for financial professionals. And quite frankly, that's the energy that some of us need, who may be in that 55-to-65-year-old age cohort, to want to stay engaged because, I can tell you right now, how do you feel, Michael, when you're able to change someone's life?

MICHAEL KITCES

It feels good. Financial planning is an amazingly, I'll call it, psychically gratifying career. That's part of what holds us in.

BILL COPPEL

Let me just ask one more question because I want to be respectful of your generosity of your time today. You've been a big advocate over the years for financial planning. In fact, in 2010, you won the Financial Planning Association's Heart of the Financial Planning Award. It really is given to individuals who have demonstrated advancing this concept of professional financial planning, life planning, that kind of thing. You have written a lot about this. And what I'm getting at is this notion of designations. Today, people can have many, many designations. And, certainly, perhaps the process and education associated with them is valuable, but how valuable are designations today in a world that has got more letters after people's names than I've ever seen before in my life?

MICHAEL KITCES

So I look at this a few ways. Designations aren't valuable; education is. Education is what matters. You can legally be a financial advisor with a high school diploma and a two-hour regulatory exam, and the diploma is actually optional. So we have a ludicrously low bar to give someone advice about their life savings. It frankly blows my mind that someone can spend 30 years accumulating your wealth, and you need a two-hour exam to learn how to tell them what to do with it. And it really doesn't actually teach you much on that exam. So our bar is incredibly low. And while that might be a fine minimum standard to be legal to give advice, in a competitive environment, it's not enough. And so, to me, the essence of pursuing designations is not getting letters for the sake of letters - although I've got a whole bunch of them after my name - it's about getting education for the sake of education. Because if you want to actually get paid for all that other advice stuff outside the portfolio, you got to go learn some stuff so you got some expertise to get paid for. And when everybody else is going to learn some stuff, you might have to go learn more and more stuff to keep ahead of everybody else who's going out to learn stuff.

MICHAEL KITCES

And so my expectation of what we're going to see in just a couple of years is marks like CFP certification are going to become the de facto minimum standard, not the aspirational, like if you get your CFP marks, you're ahead of the pack. Again, we're already at almost 30% of advisors who have CFP certification, and the percentage is rising at an accelerating rate. So in a couple of years, it will be the majority, which means just getting CFP certification doesn't differentiate you. Failing to have CFP certification will differentiate you in not a good way of being perceived as being behind others. And so I see programs like CFP certification becoming the starting point for actually getting a knowledge set that lets you begin to charge for your advice. And the advisors who really excel in this environment are going to pursue what I would call post-CFP designations, so things like CIMA, CPWA, ChFC, CLU, designations that go above and beyond just what the CFP provides so that you can go deeper and have even more expertise to be able to get paid even more for the value of your time because you know even more, for which you can get paid.

MICHAEL KITCES

And so it's certainly nice to get a couple of letters after your name. Right? Consumers also aren't certain who to trust, and so having some designations that convey that level of professionalism and credibility, I think it certainly does help. But the point is not the designations. The point is the actual education because designations on your card might give you an extra shot to have a conversation with a prospect. Right? "They got a bunch of letters after their name. This looks like a knowledgeable person." If they then sit down with you and you aren't actually knowledgeable and you aren't adding value to the conversation that you're having with them because you haven't actually studied and learned very much, this isn't going to go very well for you. Ultimately, you got to actually learn the stuff. And really, that's just what happens as we transition from an industry of products. Right?

MICHAEL KITCES

When I started, I started as a life insurance agent. I didn't need to know very much besides how our company's products worked because I didn't sell my value. I sold the value of my company's products. And I tried to pick a company that had pretty good products. Now that we're in an advice-centric world where the value is the advisor, you are the product, which means if you want a good one, you got to investment in yourself to upgrade your product for what you're offering to clients. And so, to me, that's what designations are ultimately about. And eventually, because there are too many of them, I think we'll end up consolidating them. Things like CFP certification becomes the starting point. Then you go get your post-CFP designations in the same way that doctors get their medical degrees and then board specialize, and lawyers get their law degree, and then they get their LLM specialization. So it's kind of a recognized pathway in most professions, and we're getting to the same point. But it means you have to invest in yourself if you want to sell your value.

BILL COPPEL

And that's a very great distinction. That's a great distinction you're making, Michael, because I think that it's confusing certainly to consumers. And it's about doing it for the right reasons, so this notion of being a lifelong learner and continuing to upskill yourself in a variety of ways, including these designations. To your point - and this is the distinction I hope our listeners pick up on - it's much less about the designation and much more about the quality of the information, education that you get, that positions you to become very, very effective at helping people achieve what's important to them in life.

MICHAEL KITCES

Indeed.

BILL COPPEL

Well, I want to thank you for your time today. It's been extraordinarily insightful. I hope our listeners have learned a lot. I know I have, personally. What I'd like to offer is, if folks want to follow more of your work that don't currently follow what you do and what you're writing and what you're talking about, how do they get, for example, your blog or listen to your podcast?

MICHAEL KITCES

So the name is Michael Kitces. So if you just go to kitces.com - it's a little bit of a hard name to spell, but it's kitces.com - all of our writing, all of our material is there, including all of our blog material, speaking that I do, and our podcasts. You can also find the podcast directly on, well, frankly, whatever podcast player you're listening to this podcast on. We're called Financial Advisor Success, so you can find it in iTunes, Google Play, Spotify, and all the usual spots.

BILL COPPEL

Terrific. Again, Michael, thank you for your time. And I hope that we could have this conversation again in the not too distant future.

MICHAEL KITCES

I hope so. It will be interesting to follow up on this transition period in another year or two.

BILL COPPEL

Thanks for joining us on this episode of The Next Frontier. Please feel free to share this episode with friends and colleagues that you believe would benefit from listening to Michael Kitces's thoughts and ideas. And also, please be sure to rate this episode.

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Outro

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