

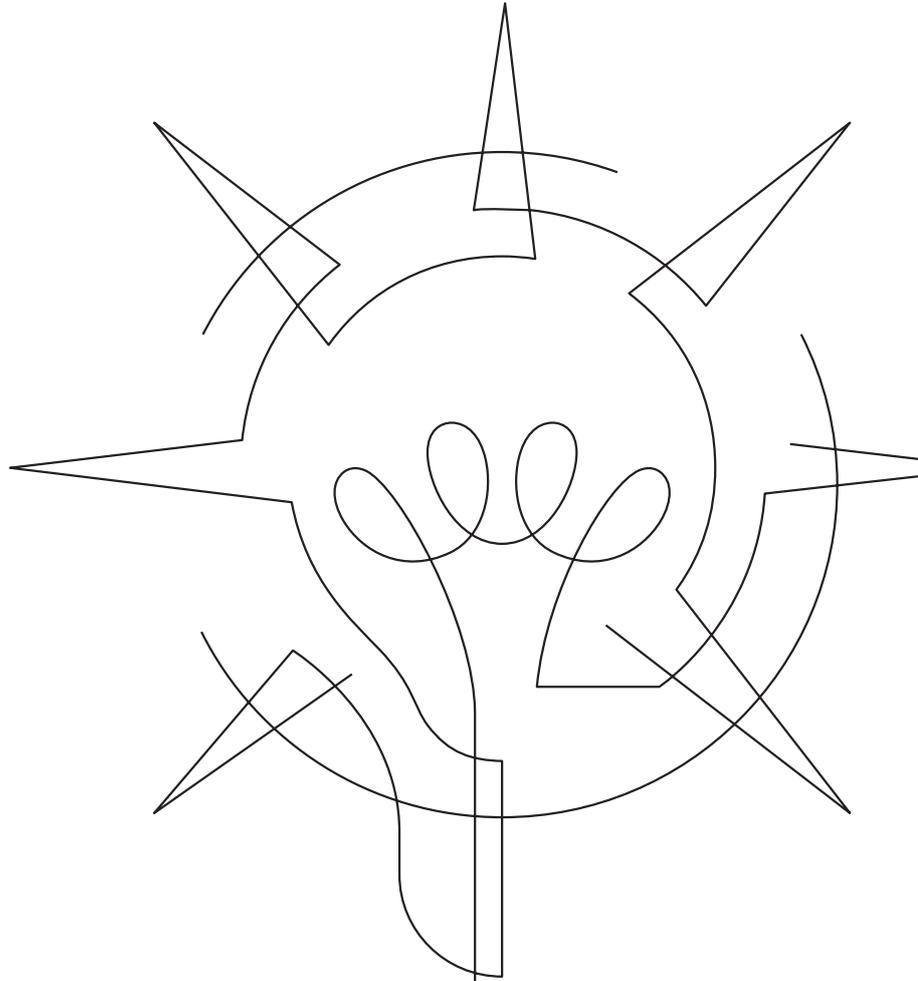
A man and a woman in business attire are looking at a tablet together. The man is in the foreground, looking intently at the screen. The woman is behind him, smiling slightly. The entire image has a green tint.

THE PRICE OF FINANCIAL ADVICE

Communicating
Fee Value Proposition
with Clarity

In recent years, many consumers have grown leery of investing and wondered whether the financial services industry have their best interests in mind. Financial advisers have always made it a priority to earn their clients' trust, but today, earning that trust is an even more pressing priority as the industry looks to recover lost ground.

The industry is making progress. Tougher regulations and a call for increased transparency have given back to investors some of their confidence, but the work is far from over. Many financial advisers are still falling short when it comes to helping their clients understand the real value of the services that they provide. This can make investors feel uneasy or even suspicious about whether their financial adviser is promoting their best interests when making investment decisions.



This made us at State Street Global Advisors wonder:

What do today's investors really think when it comes to the topic of financial advice?

Do they feel financial advisory services are worth the price?

How are their ideas about financial advisers affecting their investment behavior?

We made it our mission to find out.

OUR GOAL

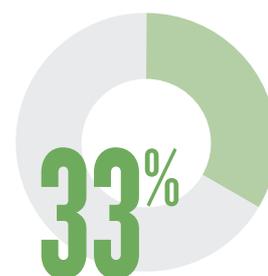
To give financial advisers an objective understanding of how investors feel about this important topic and provide them with the tools they need to gain investors' trust and loyalty.

Going into our study, we already knew one thing: Fee discussions make people uncomfortable. So our goal was not only to understand how investors feel about the value of financial advice, but also to uncover new ways to make the complex topic of fees more approachable and easier to understand.

To explore the topic of financial advisers' fee value propositions, we conducted an online survey among US financial advisers and individual investors, as well as in-depth interviews with industry thought leaders and individual investors. We confirmed what many in the industry believe – confusion is rampant when it comes to advisory fees. What we learned is that investors want to have open and honest relationships with their financial advisers, and they want to trust them. But, investor confusion about fees is getting in the way.

Evidence suggests this lack of comprehension may be directly related to the complexity of fee structure within the industry and its lack of standardisation.

We also learned that investors don't mind paying for financial advice. They're not just looking for the lowest price. They just want a clear understanding of what they're paying and what they're getting in return.



Only 1/3 of investors completely understand the fees they're being charged by their adviser.

Q: How well do you understand the fees and/or commissions being charged?

Source: State Street Global Advisors' Survey, "Financial Advisers' Value Proposition and Compensation," August 2014.

COMMUNICATING WITH CLARITY

Fee Value Proposition

While you may have mixed emotions about the topic, it's important that you and your clients are on the same page when it comes to understanding the fees you charge vis-à-vis the services you provide. Blame complex fee models, squeamishness about discussing money, or hesitancy to ask questions. Whatever the reason, many clients are mystified when it comes to advisory fees.

How can clients determine if financial advice is valuable if they don't understand what they are paying for it? **They can't.**

Investors who do not understand what they're paying trust financial advisers less and are less likely to refer them to others. This is a significant problem in a post-financial crisis world where financial advisers are looking to rebuild trust and regain loyalty. Straightforward changes, however, can improve an investor's comprehension and help inspire trust and engender loyalty among current and prospective clients without reducing fees.

No matter how fees are structured at an advisory firm, this report will provide techniques to create an ongoing dialogue about the topic and build stronger bonds with clients in the process.

Investors are seeking greater value from their financial advisers along with a clearer understanding of services provided.

Is your value proposition as clear as it can be?

Are you certain that your clients completely understand your fees?

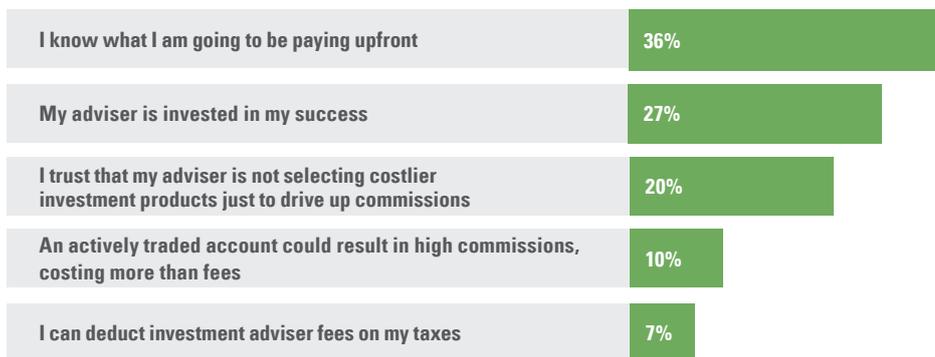
Could increasing transparency help you retain more clients?

UNDERSTANDING FEES

Do Fees Help or Hurt How an Investor Views a Financial Adviser?

Investors Seek Predictability and Transparency in Fee Structure. When it comes to compensation, financial advisers typically fall into four categories: flat fee, commission-based, fee-based or a hybrid. In our research, 75% of financial advisers said they have a primary means of charging for their services, but 25% said, “It depends.” However, investors strongly favour flat fee or fee-based compensation because of their predictability and transparency. Thirty-six percent of investors said this fee structure is most appealing because they know what they’re going to be paying upfront.

Figure 1: Reasons Why Individual Investors Prefer Fees Versus Commissions



Q: What is the number one reason you would rather be charged a fee vs. a commission?

Source: State Street Global Advisors’ Survey, “Financial Advisers’ Value Proposition and Compensation,” August 2014.

This preference has not gone unnoticed in the industry, which has been charting a slow migration towards a fee-based model. “It’s safe to say that the change is a bit glacial,” said one industry leader. “We’ve been talking about it forever. I’ve certainly heard it for the last 10 years.” Some say the process has gone on for even longer and that the trend towards fee-based compensation began about 20 years ago when transparency first became a buzzword. “People talked about it, but talk is cheap and their actions didn’t always follow,” said Mike Stevens, managing director at State Street Global Advisors Intermediary Business Group.

Uncertainty About Fees Erodes Trust

The preference for fee-only models among investors isn't surprising. Investors have historically had trouble understanding, let alone comparing, the fees they are paying their financial adviser. "We just see it over and over again. Investors don't know how much they're paying, and some people don't think they're paying anything," said Glenn Frank, director of investment tax strategy at Lexington Wealth Management.

Figure 2: Most Difficult Part of Working With Financial Advisers



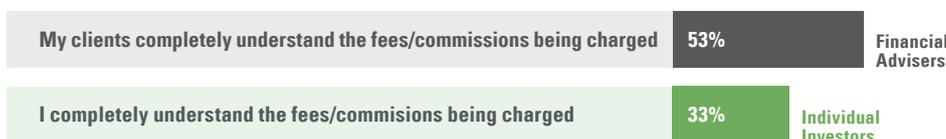
Sources: Phoenix Marketing International and Cerulli Associates: Cerulli Edge U.S. Asset Management Edition, April 2013, Issue #188.

Ultimately, the complexity of compensation models leaves investors feeling confused with a gnawing uneasiness about the whole process. That uneasiness ultimately will morph into a lack of trust in their adviser. **"If they don't understand how the financial adviser is paid, that's a problem because then they can't trust that the adviser is acting in their best interest,"** said Michael Arone, managing director and chief investment strategist at State Street Global Advisors Intermediary Business Group. Investors are more trusting of their financial advisers when they talk about these conflicts at the outset. "If you're up-front and disclose your compensation plan, your clients will have a greater level of trust in you," said Brigitte Madrian, professor of Behavioral Economics at Harvard University's Kennedy School of Government.

Financial Advisers Overestimate How Much Investors Understand About Fees

In addition to highlighting investor confusion, our research also shows a clear divide between what financial advisers are saying and what investors are hearing. Only 33% of investors completely understand how they are paying their financial adviser. Yet, 53% of financial advisers think their clients completely understand.

Figure 3: Comprehension of the Fees and/or Commissions Being Charged



Q: How well do you think most clients understand the fees and/or commissions being charged?/How well do you understand the fees and/or commissions being charged?

Source: State Street Global Advisors' Survey, "Financial Advisers' Value Proposition and Compensation," August 2014.

Recognise That Compensation is an Emotionally Charged Topic

One reason behind this lack of understanding among investors may be the fact that money discussions are culturally taboo and can prompt an emotional response from investors. In our online survey, we asked individual investors and financial advisers to share three adjectives to describe how they feel during fee discussions. We tallied all the words and created the graphs on the next page where the size reflects how frequently the word was mentioned. While both used words like "fair" and "reasonable", investors were more likely than financial advisers to use adjectives like "nervous", "worried", "uncomfortable" and "anxious". Financial advisers were more likely than investors to use words like "good", "confident", "cool" and "calm".

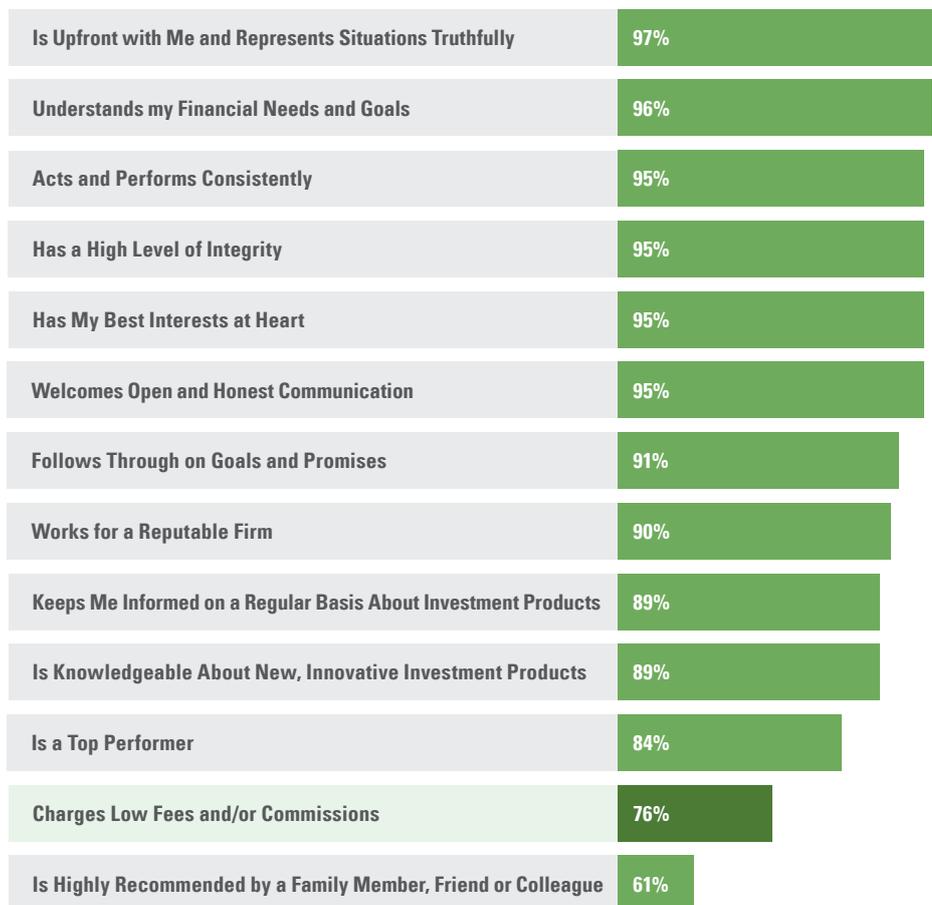
Financial advisers tend to view fee discussions more pragmatically. Hold your nose, take a quick gulp and get the medicine down. "It's not fun stuff, but obviously you've got to do it," said Frank. How smooth and simple the process is, however, may depend on an individual financial adviser's fee structure. If an adviser uses a fee-based model or commission-based model, he or she may need to explain more carefully than an adviser with a standing fee schedule, which some may perceive as easier to understand.

BEYOND FEES

Your Value is a Differentiator

Price is not a top-of-mind criteria. Financial advisers need not fear that revealing fees will spook clients, sending them off on a bargain hunt. Finding a financial adviser who charges the lowest fees and commissions is not every investor’s priority. While in many industries price is typically one of the top drivers behind product selection, this is not the case among investors. In fact, when we asked what is important when selecting a financial adviser, “an adviser who charges low fees and/or commissions,” ranked second-to-last among investors. Investors are willing to pay for the valuable partnership financial advisers provide. Investors are far more interested in selecting a financial adviser who is upfront, truthful, empathetic and follows through on goals and promises.

Figure 5: Important Criteria When Selecting a Financial Adviser



Q: How much do each of the following statements apply to your adviser?

Source: State Street Global Advisors’ Survey, “Financial Advisors’ Value Proposition and Compensation,” August 2014.

Communicating Fee Value Proposition with Clarity

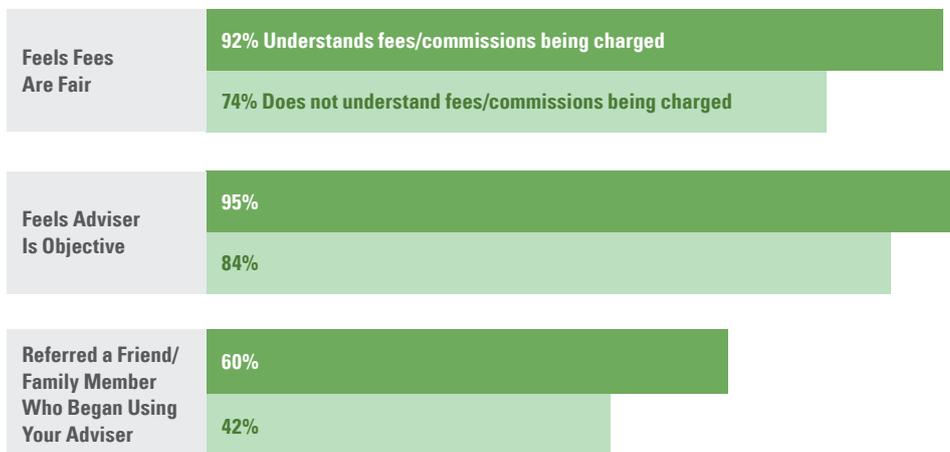
Fees are also rarely an issue when a client leaves a financial adviser. “Typically when an investor leaves a firm, the exit interview reveals problems in communication or trust, but the departure is never about fees,” said Stevens.

It’s not about lowering your fees. It’s about making sure your clients understand the fees they are paying. They’re willing to pay for the services you provide because, among other things, they don’t have the time or the expertise to navigate the complexities of the financial market.

A Clear Fee Value Proposition Can Be A Game Changer

Further analysis of our research findings gives financial advisers a strong incentive to ensure that clients understand what they’re paying. Not only can it strengthen bonds with clients, but it may help generate more business. Investors who understand the advisory fees they pay are more likely to think positively of their financial adviser than those who don’t understand. They are also more likely to believe the fees their financial adviser charges are fair, more likely to agree their financial adviser provides objective advice without regard for commissions, and more likely to refer friends or family to their financial adviser. **“Referrals are the lifeblood of our industry,”** said Stevens.

Figure 6: How Understanding Fees/Commissions Impact Investors’ Thoughts and Behaviors



Q: How fair are the fees and/or commissions being charged? Q: How much do you agree with the statement: “My adviser provides objective advice without regard to the fees or commissions he/she collects”? Q: Have you ever referred a family member, friend or colleague to your adviser, who as a result began using your adviser? Q: How well do you understand the fees and/or commissions being charged?

Source: State Street Global Advisors’ Survey, “Financial Advisors’ Value Proposition and Compensation,” August 2014.

But fees are only one side of the equation. It’s not enough to just reveal costs; investors also want to know what they’re getting for their money. Whether they’re buying a flat screen TV or an investment portfolio, people want to know that their money is well spent. “There is more pressure than ever for financial advisers to be clear about their own value in order to compete,” said Stevens. “A financial adviser’s value statement and their services have to be crystal clear to their clients and their referral sources.”

COMMUNICATING FEES

Is About More Than Money

BEST PRACTICES

1 Be Upfront, Consistent and Concise

Be completely upfront and honest with what your client is paying and what they're getting for their investment. Give the investor the information he or she needs to be confident in your services and their decision. Articulate your services clearly and keep it simple. It's about personalising performance, spelling out the important things that really matter and collaborating with your

I have discussed fees with my clients.

92%
Financial Advisers

My adviser has discussed fees with me.

67%
Individual Investors

Q: Do you discuss fees and/or commissions with your clients? Q: Does your adviser discuss fees and/or commissions with you?

Source: State Street Global Advisors' Survey, "Financial Advisers' Value Proposition and Compensation," August 2014.

clients on how you will seek to accomplish those goals.

Most investors said fee discussions happened quarterly or annually, while a small percentage of investors said they only talked about fees when their adviser was increasing them. **Financial advisers should ensure that the initial fee discussion happens at the start of any new client relationship, but this discussion should not be a one-time event.** Fee discussions should be ongoing. Discussing fees regularly improves the likelihood that clients clearly understand what you are charging them and what services they are getting in return.

2 Ensure Comprehension

If an investor doesn't understand what he or she is paying, it's difficult for them to determine value. Take the time to explain your fee structure and make sure the investor understands the process. You have to not only communicate clearly, but also be able to assess how much of that information they actually absorbed. **After providing an investor with details about fees or compensation, ask them questions so they have to repeat the information back to you. This ensures they grasp what you've told them.** Also supplement the information you've discussed with written materials that they can review later.

3 Assess Your Clients' Financial Literacy

Each investor comes into financial discussions with a different comprehension level. Assessing their financial literacy upfront allows you to tailor information to specific clients. Don't assume that just because someone is highly educated that they are financially savvy. The two don't always go hand-in-hand. As Madrian points out, "People tend to overestimate their financial literacy."

61% The global average rating of investors' financial literacy

Source: The Center for Applied Research, The Influential Investor, 2012.

Effectively communicating the value of your service doesn't have to be difficult. Adding some simple strategies can both clarify fee issues and help clients better understand the value of the services you provide.

Knowing how financially literate your clients and prospects are can allow you to fill in knowledge gaps with additional information about both fees and value. When a client comprehends the specifics of their own financial plan well enough to communicate them to someone else, the plan becomes their plan, and they begin to take ownership of it.

4 Demonstrate Your Value By Protecting Theirs

When faced with uncertainty, many investors exhibit behaviour that appears to be at odds with their stated objectives. An experienced adviser can help keep clients engaged and focused on rational decision-making to keep their financial goals in sight and protect long-term security. Success should be measured on sustainable returns, defined in terms of value to the client.

Individual investors place value on financial advisers who lead with their financial planning value proposition.¹ **As the lead wealth management adviser, it is your business to know your client better than any other financial professional. Frame your value around being a coach. It is the services you provide to your clients that will differentiate you from other professionals.**

5 Critique the Relationship

Advisers are more than twice as likely to say that they're reaching out to clients for feedback than investors report that they've been asked for feedback.

I have asked my clients for recommendations for how to improve our relationship

80%
Financial Advisers

My adviser has asked for recommendations for how to improve our relationship

33%
Individual Investors

Q: Have you ever asked your clients for recommendations about how to improve your relationship? Q: Has your adviser ever asked you for recommendations about how to improve your relationship?
Source: State Street Global Advisors' Survey, "Financial Advisors' Value Proposition and Compensation," August 2014.

Check in regularly with your clients to find out what's working and what's not. This not only gives you valuable information to improve your practice, but also lets clients know you're responsive to their needs. **Advisers who survey their clients regularly have a clear understanding of what their clients are looking for and how well they are delivering on those desires.**

Why Addressing Both Sides of the Value Equation is Critical

In the end, our research suggests that **communicating fees clearly is about far more than money. It's about building trust and demonstrating value**, and proving to your client that your partnership is the wisest of all their investments.

Ultimately, investors are willing to pay when they know they are getting a worthwhile service in exchange for their money. Today's post-crisis investment market is changing. Investors are wary and pushing for more price transparency, making it more important than ever to promote the value of your own services to clients, said Sterling Shea, associate publisher and head of advisory and wealth management programs at Barron's, a US financial publication. Advisers who have the ability and skill to provide more authentic advice are going to be able to charge more for it and flourish. "More volatile markets also will expose the mediocrity in the industry. There will be huge pressure on those who provide less comprehensive advice with more variable fees," said Shea.

To clearly communicate your value you have to sweep away the layers of fog and confusion around fees, communicate your value proposition clearly and truly allow your clients to see your worth.

Research Methodology

A nationally representative sample of 300 financial advisers and 300 individual investors in the US participated in an online survey undertaken by State Street Global Advisors Practice Management and a2bplanning in August 2014.

The adviser sample is representative across different channels: independent broker/dealer, multi-platform/direct, national broker or wirehouse private bank and registered investment adviser, all with average accounts under management of at least US\$500,000. The investor sample is representative across both net asset bands (below \$1 million; \$1 million to \$5 million; and above \$5 million) and age bands (25 to 39; 40 to 49; 50 to 59; 60 to 69; and 70 and older) Quotas were established to ensure the sample reflected the investment landscape today. All statistical significance is reported at 95%.

The surveys explored nearly identical themes, which allowed us to compare financial advisers' presumptions about their clients against how investors actually feel. The data collected from this survey were segmented and analysed to extract insightful and actionable opportunities.

Questions were grouped into the following categories:

- How well do investors understand financial adviser compensation?
- What role do fees play when an investor is choosing a financial adviser?
- Does understanding fees help or hurt how an investor views a financial adviser?
- Do investors think that the fees financial advisers charge are fair?

To further contextualise our learning, we also conducted qualitative research with a range of leading industry, business and economic experts to help inform our key findings and practice techniques. They included:

- Phone interviews with 14 subject matter experts.
- In-home interviews with investors with a household portfolio of at least \$150,000. If investment decisions were shared with a spouse, the spouse was included in the interview.

Acknowledgments

We would like to express our deep appreciation to the industry experts, financial advisers and investors who participated in our survey as well as our in-depth interviews. Your insights guided our thinking and inspired our tactical recommendations.

We also thank a2bplanning for their invaluable contributions.

¹ Cerulli Associates, The Cerulli Report: "U.S. Retail Investor Advisor Relationships 2014, Evolving Roles in Client Relationships".

Definitions

Flat Fee a fee that neither rises nor falls

Commission-Based a fee structure that incurs charges when an investor opens an account or sells a financial product

Fee-Based a fee structure that is based on assets under management

Hybrid a fee structure that combines the aforementioned structures

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* Assets under management were US \$2.30 trillion as of March 31, 2016. AUM reflects approx. US \$32.6 billion (as of March 31, 2016) with respect to which State Street Global Markets, LLC (SSGM) serves as marketing agent; SSGM and State Street Global Advisors are affiliated.

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Our programs are grounded in proprietary research and leverage the latest thinking and trends from both industry and academia. We offer a diverse range of capabilities that address forces shaping the investment landscape; best practices to drive results and optimize your business; conversation starters to guide and engage with clients; and continuing education to hone techniques and accentuate your value.

on such information. Investing involves risk including the risk of loss of principal.

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