

A person is shown from the waist down, in a starting crouch on a red running track. They are wearing black shorts and blue and white sneakers. Their hands are on the ground, and their feet are on starting blocks. In the background, there are white lane markers with numbers 8, 7, 6, and 5. A large yellow triangle is overlaid on the right side of the image, containing the text.

Goals-based planning

A personalized service for
strengthening
client relationships



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- Money in motion
- Customer analytics
- Implementing goals-based planning and product allocation

Goals-based planning: a personalized service for strengthening client relationships

Since the global financial crisis and ensuing recession, the desires – and fears – of investors have changed dramatically. Investors seem less confident and more risk averse than they were just a few years ago. They want more – and better – advice from financial advisors, yet they also want to wield more control over their financial lives. This cognitive dissonance makes success more difficult for financial advisory firms as they strive to attract new retail investors and consolidate and grow existing clients' assets.

Making matters more complicated, many investors today, whose memories of the crisis are still fresh, insist on being served according to their unique wants and needs. This task is certainly difficult given that financial services firms are seeking to rationalize many parts of the business and take advantage of any economies of scale. In fact, a recent EY survey¹ found that 76% of wealth managers plan to institute a unique service model for each of their client segments in the next two to five years.

So how can firms develop a scalable framework and service model for financial advisors to address the unique wants and needs of individual investors? One strategic option is the use of goals-based planning, which provides a consistent framework to engage a broad range of clients with different requirements. It is a core structure or “backbone” on which individually tailored programs can be built.

Institutional investors, such as pension funds, endowments and insurance companies, have used goals-based planning for decades to make certain they have adequate funds available to meet future liabilities.

More recently, however, financial advisors began adopting goals-based planning for retail investors. Goals-based planning holds many advantages over traditional financial planning, including providing clients with a greater sense of clarity and control over their financial lives and increasing their confidence in making investment-related decisions. Savvy financial advisors are using goals-based planning as a firm-wide strategy to attract clients, gain their trust and build long-term relationships by focusing on meeting tangible short-, intermediate- and long-term financial needs over the course of their lifetimes.

¹ *Enhancing the advisor and customer experience through technology*, Ernst & Young, December 2012.



Traditional financial planning versus goals-based planning

An understanding of the differences between traditional financial planning and goals-based financial planning is critical to leveraging goals-based planning on a firm-wide basis. The following are some of the key differences.

How growth is viewed – In traditional financial planning, a financial advisor usually begins by looking at a client's investable assets as a single portfolio and then moves on to talking about the client's life goals before developing a strategy to grow that portfolio. Ideally, the client can leverage the growth of his or her assets to fund various needs.

However, one of the key benefits that firms and their individual advisors gain from goals-based planning is that it approaches growth the same way institutions do: growth is necessary to meet future liabilities. Goals-based planning first looks at a client's specific objectives, divides them into "buckets" and then examines all of a client's assets (not just investable assets) as they relate to these

buckets. For example, assets in a 401(k) are allocated to the retirement goals bucket. Specific investment strategies are then developed for each bucket, based on the investor's current asset base, risk capacity (i.e., investor's ability to assume risk) and his or her goal for that bucket (e.g., grow retirement fund to US\$5million by age 60).

How progress is viewed – Traditional financial planning measures progress and performance against market benchmarks while goals-based planning measures progress against a client's unique goals. Goals-based planning is an outgrowth of behavioral finance, which focuses on the psychological and economic theories behind how individuals make decisions about money – and how they make mistakes managing it. Behavioral finance assumes that individual experience, personality traits and unexpected market outcomes significantly influence individual investment decisions. Goals-



based planning helps to prevent emotional investment decisions by providing a clear, straightforward process for identifying goals, choosing investment strategies to meet them and measuring progress toward them. Clients do not chase returns; instead, they focus more on what's important to them and how they intend to live their lives.

How risk is viewed – Traditional financial planning places market volatility at the top of the list of risks to mitigate. Therefore, financial advisors gauge an investor's risk tolerance or risk preference (i.e., an investor's aversion to risk) to help drive his or her investment strategy. In the goals-based approach, mitigating market volatility is still an important consideration, but the chief risk is the failure to reach a specific goal. With goals-based planning, a financial advisor not only gauges an investor's risk tolerance, but also the investor's risk capacity for each goal – with a greater emphasis on risk capacity.

In terms of risk, traditional planning can leave investors exposed to unintended consequences. When an investor's risk tolerance exceeds his or her risk capacity, there can be a detrimental effect on the portfolio, slowing the progress toward achieving life goals – as when the dot-com bubble burst in 2001 and 2002 and again in the stock market downturn of 2007 and 2008.

Alternately, by aligning an investor's asset allocation to an investor's risk capacity for each goal, the financial advisor makes the planning process both more efficient and more flexible. For example, an investor would have less risk capacity for an essential goal (e.g., funding a child's education), which calls for a more conservative investing approach, but would have greater risk capacity for a non-essential or discretionary goal (e.g., buying a vacation home), which calls for a more aggressive one.

Key differences between traditional and goals-based planning

	Traditional financial planning	Goals-based planning
How clients are profiled	Based on: <ul style="list-style-type: none"> ▸ Financial factors ▸ Single risk tolerance 	Based on: <ul style="list-style-type: none"> ▸ Financial and behavioral factors ▸ Client's goals ▸ Prioritizing goals
How performance is measured and its effects	Relative to market performance/ benchmarks: <ul style="list-style-type: none"> ▸ Promotes shorter-term views, reacting to the market and chasing returns 	Against progress toward goals: <ul style="list-style-type: none"> ▸ Promotes a longer-term, proactive view
How risk is measured	Assesses overall risk tolerance for entire portfolio	Assigns confidence level based on priority for each goal <ul style="list-style-type: none"> ▸ Assesses risk capacity for each goal ▸ Considers the potential "failure to reach a goal"
How assets are allocated	Based on a single portfolio	Based on asset class portfolio for each goal

Goals-based planning in action

In a typical goals-based planning scenario, goals are prioritized and each goal is assigned a confidence level: essential (95% probability of success); preferable (75% probability of success); and discretionary (50% probability of success). The confidence levels drive the cost of funding each goal.

For example, investors can be advised that short-term security is essential and that they should have the equivalent of six months of cash for spending in a highly liquid emergency fund. This goal requires a low-risk, low-return strategy that might employ making deposits to a money market or a bank savings account.

Funding all or part of a child's educational expenses is usually considered another essential goal, but it clearly has a longer time horizon than short-term financial security. In this case, a financial advisor would work with an investor to allocate a portion of the portfolio to products that offer better returns than a money market account while incurring only moderate risk. Another essential goal, funding a comfortable retirement, which generally has an even longer time horizon than funding a college education, may require a more aggressive strategy – one that involves taking on more risk in favor of greater potential returns.

Of course, financial advisors must continually monitor a client's progress toward these goals rather than simply making certain that a client's portfolio beats a

benchmark. Circumstances can arise that will make it easier or more challenging for an investor to meet his or her objectives. For example, taking a job with a pension benefit or buying an annuity can greatly decrease the need for a self-funded retirement account, while having a son or daughter who plans to join the armed forces may decrease the investment needed to pay for college. An employment contract or severance agreement can reduce the need for an emergency fund, but a breadwinner facing health problems might increase the necessity of such a fund.

A goals-based financial advisor must have a thorough understanding of a client's life goals, as well as a client's assets and investment style. Once a client's goals and liabilities are clearly defined, a financial advisor will need to work with him or her to set priorities and establish a timeline for each goal. This will prompt the client to think more carefully about the relative importance and urgency of each goal and will lead to a clearer picture of what the client wants out of life and a financial plan to achieve it.

After final approval and implementation of a goals-based plan, the financial advisor must stay in close contact with the client. Although the advisor may have developed the best plan possible after a thorough analysis of goals, assets and liabilities, life changes necessitate regular reviews and revisions of the plan to reflect new circumstances and objectives.

Illustrative example of prioritized goals-based plan

	Short term	Intermediate term	Long term
Essential goals	Emergency fund	Child's public four-year college	Essential retirement expenses
Preferable goals	Annual family beach vacation	Child's private four-year college	Luxury vacation each year for first 10 years of retirement
Discretionary goals	New car	Child's graduate school	Vacation home in Florida

The benefits of goals-based planning

The overall benefit of goals-based planning is a sharper, more focused plan for both client and advisor. This results in a better understanding of each goal, its priority relative to other goals, the amount of savings devoted to each goal and the ability to view the trade-offs and priorities across all goals. For example, funding a short-term discretionary goal may affect a longer-term goal (e.g., saving for retirement). With goals-based planning, it is easier for the advisor to have a productive conversation about the trade-off with client. This is not to say the client should forego the short-term goal, but the advisor can make sure the client understands the impact of his or her decision.

For a financial advisor, goals-based planning promises multiple benefits: an increased sense of trust and confidence from the client; greater potential for a

long-term relationship with a client based on meeting life goals rather than performance; fewer redemptions amid market turbulence; and the possibility of consolidating and growing existing clients' assets.

Many firms are making major investments in developing goals-based planning platforms, including educational programs for advisors, new software to facilitate the goals-based approach and informational and marketing programs aimed at investors. Goals-based planning is clearly not the newest trend that will go out of style in a few years – it is the next evolution of financial planning.



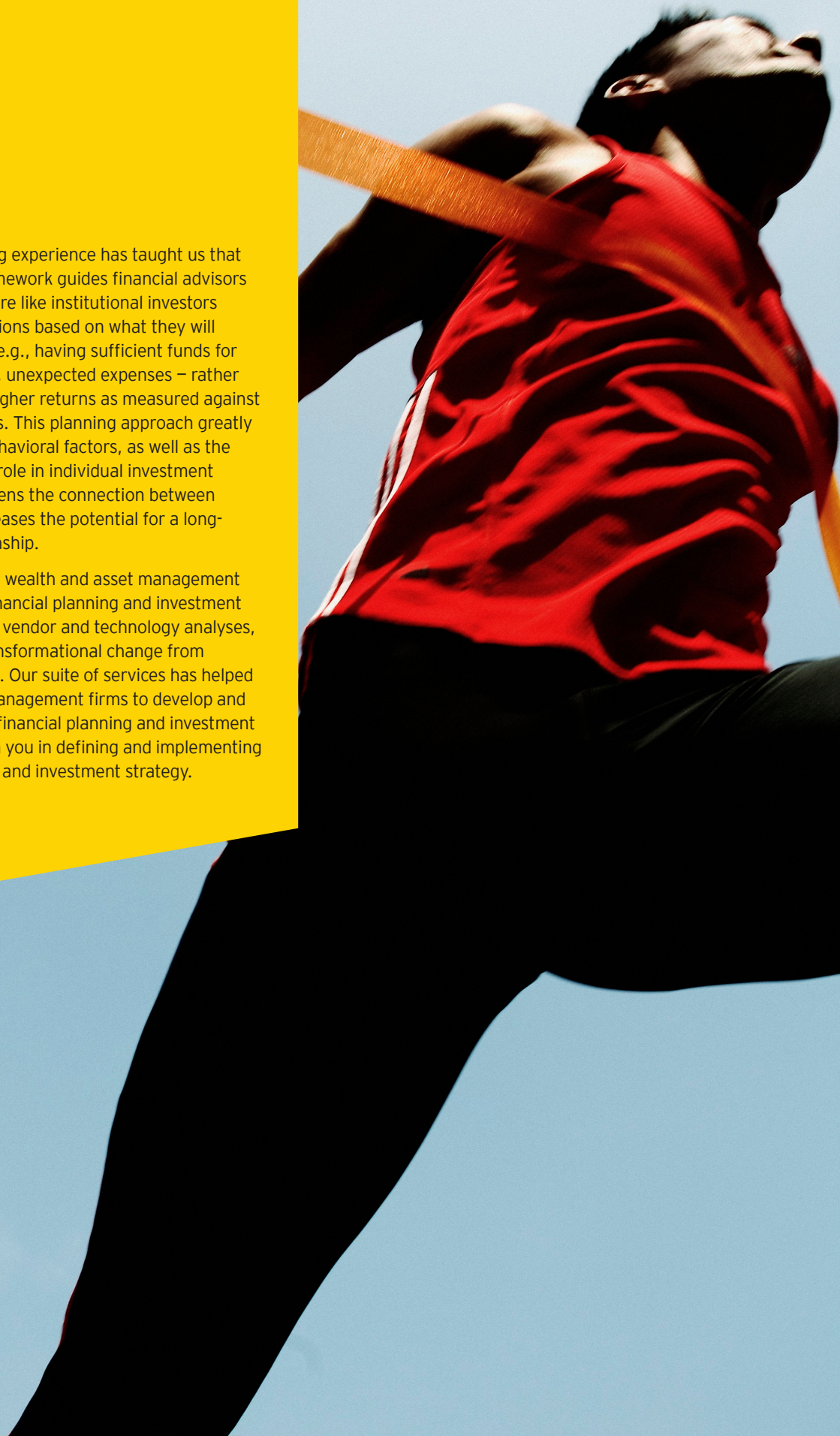
Benefits of goals-based planning

	Company benefit	Advisor benefit	Client benefit
Highly customized planning and advice	<ul style="list-style-type: none"> ▸ Attracts clients as few companies offer goals-based planning ▸ Increases client retention as multiple customized portfolios tailored to the client create deeper client relationships and “stickiness” ▸ Attracts and retains advisors – by eliminating the implementation and monitoring complexity, advisors will consolidate their book of business to the financial institution 	<ul style="list-style-type: none"> ▸ Differentiates service offering in the marketplace and creates the transparency needed for trusted, lifelong client partnerships 	<ul style="list-style-type: none"> ▸ Maps clients’ goals to optimized portfolios based on risk tolerance, risk capacity and time horizon, resulting in high suitability correlation
Interactive client experience	<ul style="list-style-type: none"> ▸ Retains clients as client is less likely to change advisors because of joint development of the investment plan 	<ul style="list-style-type: none"> ▸ More actively engages clients throughout planning and investment process, so they become more invested and less likely to change 	<ul style="list-style-type: none"> ▸ Enhances decision-making ability on investment products ▸ Increases risk/return understanding ▸ Bolsters confidence (in a down market) and trust (in advisor)
Asset growth and retention	<ul style="list-style-type: none"> ▸ Offers opportunity to move assets held to fund a specific goal ▸ Makes it less likely to lose assets that are tied to a specific goal 	<ul style="list-style-type: none"> ▸ Holistically planning goals leads to clients consolidating assets ▸ Lessens likelihood of losing clients due to “irrational behavior” during periods of market volatility 	<ul style="list-style-type: none"> ▸ Instills confidence that the most cost-effective portfolio/ product is selected for each goal
Risk reduction	<ul style="list-style-type: none"> ▸ Satisfies investment suitability requirements ▸ Reduces regulatory inquiries, fines and penalties ▸ Reduces customer complaints and suitability cases 	<ul style="list-style-type: none"> ▸ Reduces advisor’s need to constantly chase alpha or explain performance; clients measure performance against ability to meet goals rather than against market benchmark 	<ul style="list-style-type: none"> ▸ Reduces asset flight due to downturn in market ▸ Lowers retention risk as funds are periodically directed to new goals ▸ Decreases suitability risk as client has better, deeper understanding and his/her profile is directly matched to products

Conclusion

At EY, our financial planning experience has taught us that a goals-based planning framework guides financial advisors to help individuals think more like institutional investors and make investment decisions based on what they will need to meet their goals – e.g., having sufficient funds for retirement, a second home, unexpected expenses – rather than investing to achieve higher returns as measured against various market benchmarks. This planning approach greatly reduces the influence of behavioral factors, as well as the emotions that often play a role in individual investment decisions. Thus, it strengthens the connection between advisor and client and increases the potential for a long-term, even lifelong, relationship.

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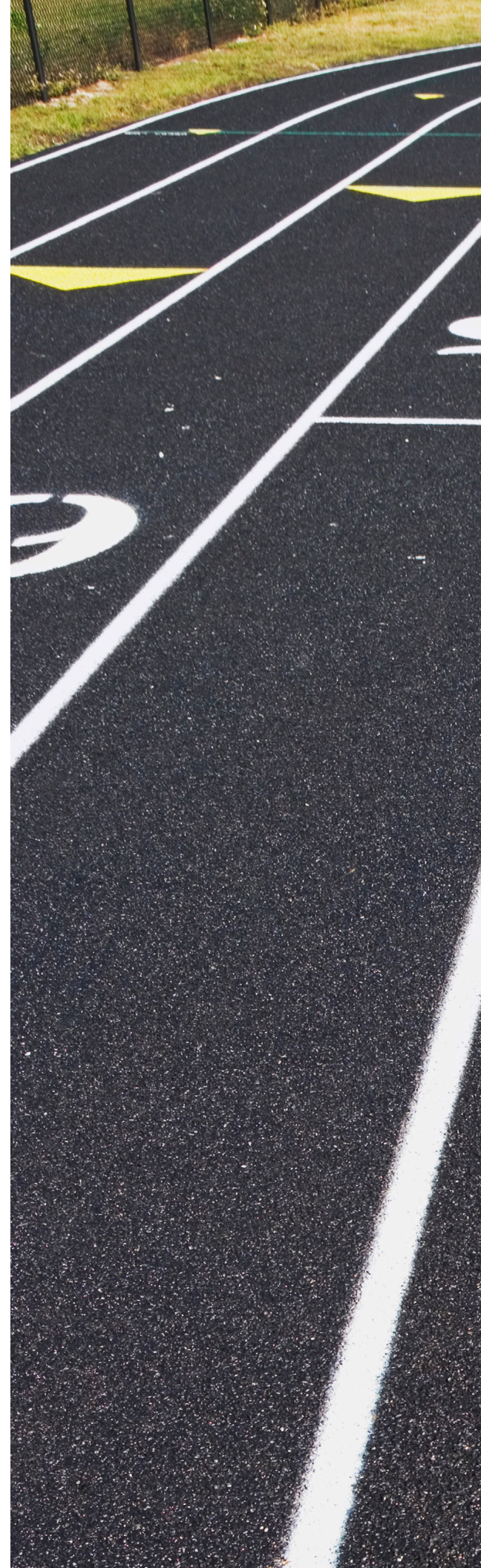
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