Diversity is Good Business for Advisory Firms

How firm and investor preferences may be at odds

INSIGHTS FROM FLEXSHARES' 2021 RESEARCH

2021 vs. 2019: At a Glance

Changes in consumer preferences:

- **Advisors backed by a team:** 82% vs. 72%
- **A diverse advisory team:** 58% vs. 30%

Changes in advisors' views/action:

- **Staff diversity a priority:** 52% vs. 45%
- **Firm leadership driving DE&I:** 67% vs. 59%
- **Advisors' focus on client segments:**
  - **Gender:** 62% vs. 36%
  - **Sexual orientation:** 34% vs. 15%
  - **Race or ethnic-based groups:** 35% vs. 14%
  - **Gen X:** 43 vs. 20%
  - **Millennial/Gen Z:** 38% vs. 22%

THE CHANGING LANDSCAPE OF DIVERSITY

To arm financial advisors with the insights they need to grow their businesses and deepen client relationships, FlexShares regularly conducts in-depth research on a variety of topical issues.

In 2019, we conducted a survey of high-net-worth consumers and financial advisors concerning their views on diversity, equity and inclusion (DE&I), encompassing questions of race, age, gender and sexual orientation. Since those issues weigh on the minds of many in our industry, particularly in the wake of protests that began in the summer of 2020, we fielded another survey to see what, if anything, had changed.

Our first study focused on the motivations and mechanics of hiring for diversity as well as the demand for it among consumers. Building on that, our 2021 study explores whether attracting a diverse client base is perceived to be a strategic priority and what, if anything, advisors are doing to make that happen. We also wanted evaluate how recent events have affected advisors' perceptions of DE&I.

The findings of this research demonstrate that there are strong business reasons for prioritizing DE&I efforts, beyond the social imperatives. In addition to presenting the results of the research, conducted in spring 2021, this paper will offer suggestions and action steps that advisors and their firms may take.

DE&I: THE IMPACT OF 2020 AND CHANGING WEALTH OWNERSHIP

There is no disputing that in 2020, America found its voice and took it to the streets to highlight the many inequities in our society. Whether it was protests for racial equity, fighting for LGBTQ rights or for equal pay for women; people were not shy in voicing their opinions, and corporate America took notice.

While financial firms have been working toward building more diversity and inclusion for many years, the needle hasn't moved much. In the 2021 survey we wanted to understand if the attitudes of advisors had changed with the events of 2020, so we asked about the impact of the protests around racial equity specifically.

A quarter of advisor respondents report that the protests changed the way that they – and their firms – think about DE&I. About a third would like their firms to focus on DE&I more and 13% acknowledge that there is growing consumer support for DE&I. About a third (30%) say that their firms took active measures to enhance diversity, equity and inclusion, most often by adding education and training or making changes to hiring practices.

A broadening of wealth ownership

For generations, the demand for investment advice by individual investors came from a relatively small, affluent sector of the U.S. population, which was dominated by older, white males. The financial advisors who served them tended to mirror those demographics. And, while we've seen an expansion in the demographics of wealth ownership, financial advisory continues to be primarily white and male.

The introduction of Individual Retirement Accounts and a shift from defined benefit retirement plans to defined contribution plans that began in 1970s' — increased and broadened the base of "traditional" investors. Since then, major demographic changes have further widened the base of wealth management clients.

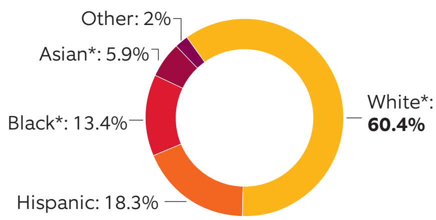
Women investors have become particularly important, with McKinsey estimating that by the end of the decade they will control much of the $30 trillion in financial assets that Baby Boomers will possess — a potential wealth transfer that approaches the annual GDP of the United States.[1]

And despite significant and persistent gaps compared to white families, gaps which historically have been exacerbated by economic downturns, Black and Latino family wealth grew at a faster rate than that of white families from 2016 to 2019.[2] Also boding well for the future is the rising number of Black and Latino college graduates, up 75% and 202%, respectively, between 2000 and 2016.[3]

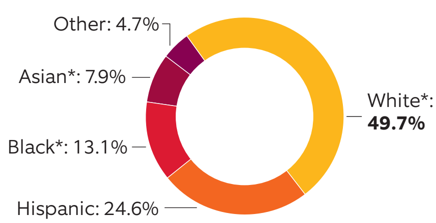
U.S. Demographics Are Changing

In 2045 less than half of the population will be white

U.S. DEMOGRAPHICS IN 2019



U.S. DEMOGRAPHICS IN 2045



Source: Metropolitan Policy Program, Brookings Institution.

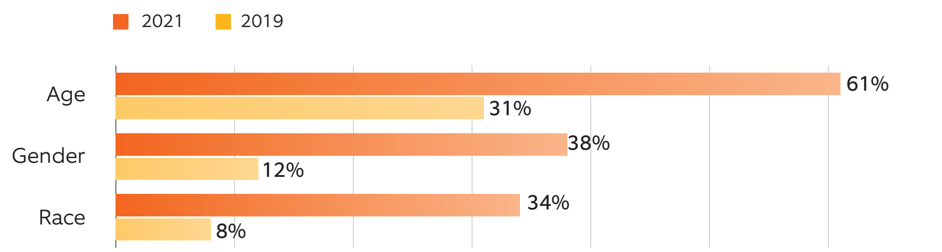
THE DISCONNECT: CONSUMER PREFERENCES VS. TODAY'S LANDSCAPE

Many survey data points underscore that current and prospective financial advisory firm clients favor working with advisors like themselves. When asked about important advisor characteristics, 72% of those who felt an advisor's gender was important to them — about half of all consumers — say the reason for that choice was because they want an advisor of their gender. Of those who feel that race is important, 84% say that having a same-race advisor was an important consideration.

> Preferences for affinity are becoming more pronounced.

If anything, certain preferences for affinity are becoming more pronounced. The study found that among individuals who work with an advisor, clients are significantly more likely than those in 2019 to have a preference on their advisor's age (61% vs 31%), gender (38% vs 12%) and race (34% vs 8%). This is largely due to wanting an advisor of the same demographic.

ADVISED CLIENTS PLACE MORE IMPORTANCE ON THESE CHARACTERISTICS OF THEIR ADVISOR IN 2021 VS. 2019



> When searching for an advisory firm, more than half of consumers say they ask about the firm's commitment to DE&I.

There are similar trends for consumers not yet working with an advisor. In 2021, 47% of non-advised consumers state that gender would be an important factor when hiring an advisor compared to 24% in 2019. Among all consumers (advised an not advised) that indicated an advisor's gender is important – 72% attribute it to wanting an advisor of their own gender. And women today are five times more likely than men to use a female advisor, up from four times in 2019.

The fact that people seeking financial advice typically prefer to work with those who are in some way like themselves, highlights the disconnect between what the advisory space looks like versus wealth ownership trends and changing U.S. demographics.

Consumers expect advisory firms to embrace diversity

And it's not just that consumers want to find an advisor like them. They are also interested in the commitment of an advisory firm to diversity, equity and inclusion. More than half (51%) of consumer respondents say that when seeking an advisory firm, they directly ask about the firm's commitment to DE&I.

Firms of all types have cited the need to match their workforces to better reflect the current and future client universe, but the needle hasn't been moving. This reality exemplifies how legacy recruitment programs and the tendency of successful advisors to remain in their jobs, among other reasons, have left the industry with a workforce that is not keeping pace with changing demographics.

51%

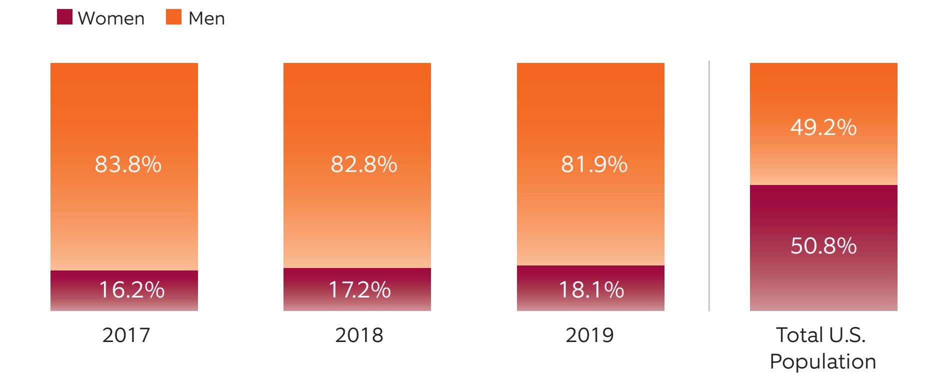
of all consumers say race is important when choosing an advisor.

84%

of those with a preference say they prefer an advisor of the same race

Despite consumers' desires for more diversity in choice of advisors, we're not seeing meaningful diversity of either gender or race reflected in the advisor population. The charts below highlight the disparity.

ADVISORY BUSINESS NOT KEEPING PACE WITH CHANGE: GENDER

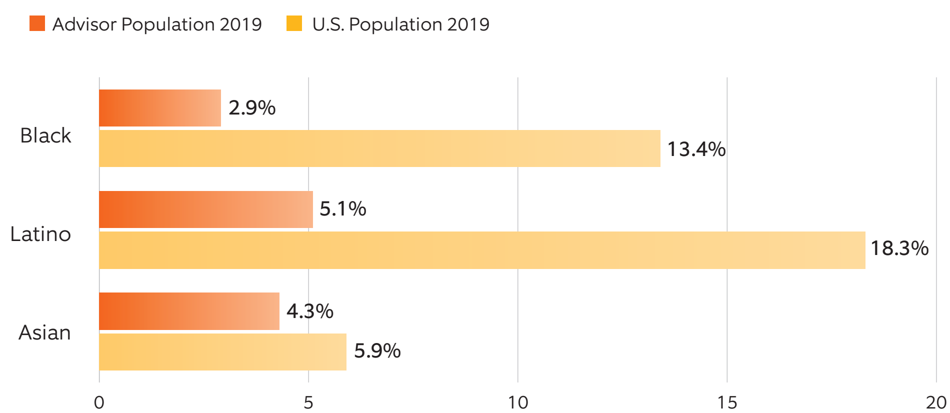


Sources: Cerulli Associates, Meridian IQ, Investment Company Institute, Insured Retirement Institute, VARDS, Strategic Insight/SIMFUND, Investment News, Judy Diamond, Department of Labor, PLANSPONSOR, S&P Capital IQ MMD, Financial Planning, Financial Advisor Magazine, Investment Advisor Magazine, and Cerulli Associates, in partnership with the Investments & Wealth Institute, WealthManagement.com, and the Financial Planning Association (FPA)

White consumers in particular are much more likely than others to indicate that these factors are important characteristics when selecting an advisor. Of all consumers with a preference, 43% of white consumers indicate their advisor's race is meaningful to them, while only 14% of non-white consumers feel race is an important consideration.

In short, advisors and firms must change in order to meet the needs of a customer base that is becoming younger, more female and more racially diverse.

ADVISORY BUSINESS NOT KEEPING PACE WITH CHANGE: RACE



Source: 2021 Cerulli Associates and Metropolitan Policy Program, Brookings Institution.

Benefits for firms focused on DE&I

Easier recruiting.
77% of advisors at firms focused on DE&I report success in hiring professional talent vs. 56% of other firms.

Better retention.
Advisors report strong 5-year retention rates of diverse talent at their firms.

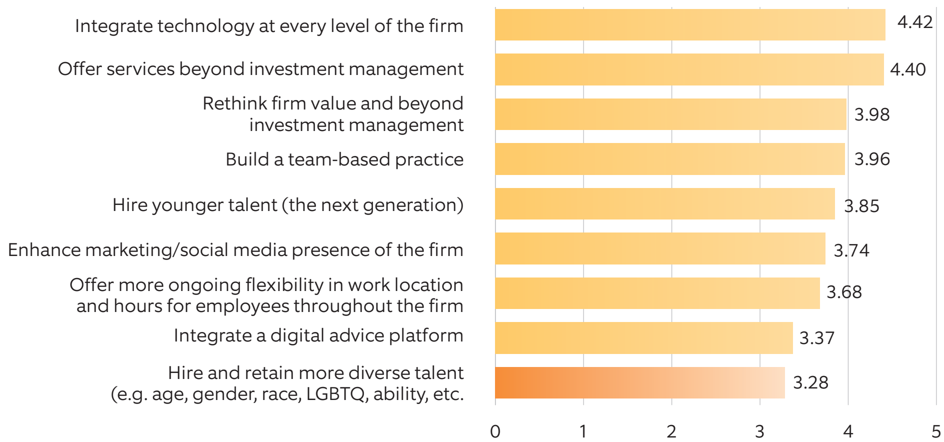
Well defined career paths.
A majority (80%) of advisors at these firms report having well-defined career paths vs. 56% of those at firms without a DE&I focus.

Aid in client acquisition.
DE&I programs have been used to successfully aid client acquisition, say 46% of respondents.

THE DISCONNECT: THE PRIORITY OF DIVERSITY VS. ITS BENEFITS

While advisors are more likely to acknowledge the importance of diversity, equity and inclusion in 2021, firms are not prioritizing it. Respondents were asked to rank nine strategic initiatives on a scale of 1 (not important) to 5 (extremely important). While hiring and retaining diverse talent moved higher on the scale — to 3.28 in 2021 from 2.7 in 2019 — it fell to the #9 spot in priority from #8 in 2019. Yet firms that are taking action on diversity are reporting demonstrable business benefits as a result.

DIVERSITY STILL NOT A HIGH PRIORITY



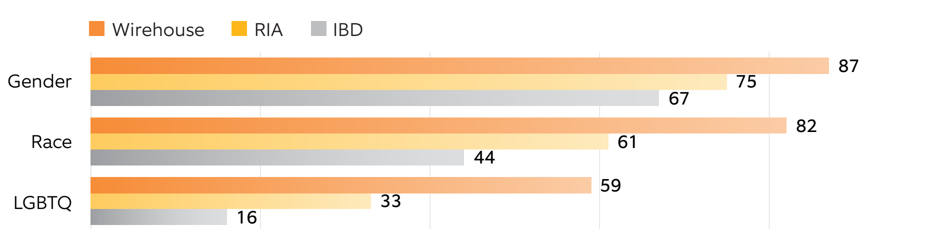
Firms focused on DE&I report easier recruitment, strong retention

This disconnect, in part, may be due to the perception that improvements in DE&I are "soft" benefits whereas other priorities — more technology, a wider array of services and different marketing — have hard dollar payoffs. In truth, internal and external DE&I efforts are yielding solid business benefits.

Efforts to make recruiting more inclusive have led to hiring success – a key strategic priority for firms preparing talent needs for the next generation. More than three-quarters (77%) of firms focused on DE&I report success in hiring new professional talent, vs 56% of those firms that are not taking action. Moreover, more than half of respondents (58%) from firms acting on diversity say that their firm's DE&I program has been a selling point in attracting new hires. Additionally, these firms have strong 5-year retention rates of diverse talent. This can have a meaningful impact on a firm's bottom line. Less turnover means fewer dollars spent on recruiting, hiring, training and lost productivity.

5-YEAR RETENTION RATES OF DIVERSE TALENT

(Percentage retention rates of firms taking action on diversity)



of firms that are taking action on diversity say the culture of their firm has improved as a result.

Firm culture has improved

How have DE&I efforts in the area of personnel fared? In a word, they work. A majority of advisors (55%) are with firms taking action on diversity say the culture of their firm has improved as a result. Overall, 55% describe their firm's experience in having diverse staff members as either good or great, up from 45% in 2019.

Larger firms are leading the way

Due to their size, resources, staffing depth and, often, a prominent public image, larger firms have been leaders in DE&I. Larger firms in all channels have been more likely to:

- View staff diversity as a strategic priority.
- Create a culture of inclusion.
- Hire and retain diverse talent — women, people of color and LGBTQ professionals.
- Use their diversity program as a way to recruit new talent and clients.
- Be open to hybrid work arrangements.
- Grow diversity by adjusting recruiting process, training and marketing.

DE&I ACTIONS THAT LEADERS ARE TAKING

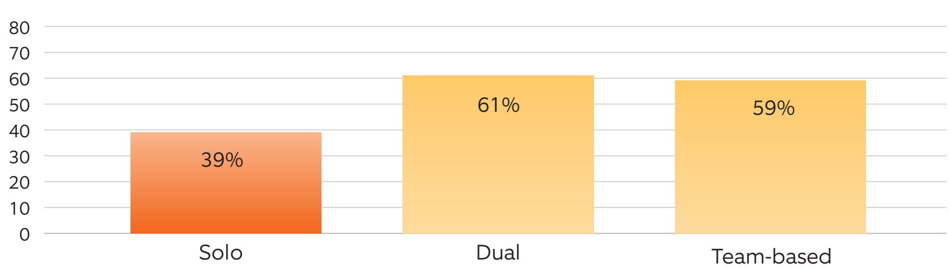
What About Small Firms and Solos?

There is a marked difference in results among solo firms, which accounted for 38% of the advisors surveyed. Just 39% of solo advisors feel DE&I should be prioritized vs. 61% of dual practitioners and 59% of team-based advisors.

39%

of solo advisors feel DE&I efforts should be prioritized.

DE&I IS LESS OFTEN A PRIORITY FOR SOLO PRACTITIONERS.



Many solos are also sole proprietorships and unlikely to have much staff. However, 64% of solo advisors respondents say they intend to build more robust teams and 54% are actively recruiting professional talent. This compares to 68% of dual practitioners and 75% of team-based firms that are actively recruiting professional talent.

DE&I: PREPARING FOR THE FUTURE

74%

of respondents say that Baby Boomers represent the majority of their clients.

Changing demographics and wealth ownership patterns will continue to be a challenge for the financial advice industry. About 74% of respondents say that Baby Boomers (ages 56-74) represent the majority of their clients. Trailing substantially, at 13%, are those who say GenX (40-55) accounts for the bulk of their clients and just 1% who have a majority of millennial clients.[5]

But Millennials (ages 25 to 40) have already overtaken Boomers in terms of population[6] and, along with GenX, are building wealth as they age. Moreover, many Boomers are spending down their wealth as they navigate retirement and are likely to bequeath what remains to younger generations. For the financial advice industry, this means that a focus on the nation's future affluent population is important to ensure ongoing viability, which translates into serving the upcoming wealthy in ways that appeal to them, not their parents.

Reasons for Seeking A Diverse Client Base

Survey responses reflect recognition of this demographic reality. When asked what were the strongest reasons for attracting a diverse client base, respondents cite the opportunity to increase the size of the eligible market and to educate a wider diversity of people about the benefits of planning and investing.

Client Focus of Firms Taking Action On Diversity

73%	47%	46%
have efforts aimed at attracting women clients	have efforts aimed at attracting race and ethnic-based groups	have efforts aimed at attracting the LGBTQ community

Women are 5x as likely to work with a female advisor

More women needed to serve more women

For firms to attract women clients, having female advisors is key. Among those working with an advisor, women were almost five times as likely as men to use a female advisor. Given the rise in the number of professional women, the growing level of wealth they control, the increase in women's longevity and anecdotal evidence that large numbers of advised women change advisors upon the death of, or divorce from, their husband, a focus on attracting and retaining female clients is eminently logical.

IDEAS TO CONSIDER

In trying to benefit from the opportunities that DE&I efforts can afford, one size does not fit all, nor does one strategy. Larger firms enjoy a wide array of possibilities to enhance their ability to attract and retain a diverse workforce. For smaller firms and solo practitioners, the choices are fewer. But each has a role in expanding the diversity of the financial advice business.

Based on the survey's findings, here are some suggestions for each group, but many of these can cross over between the groups.

For larger firms in all channels:	For solo practitioners, small firms and organizations that serve them:
Create and support teams. Team roles in operations, technology, marketing and analytics provide many entry points for those who are younger and not sales-focused, and for those who traditionally have had little or no exposure to financial advice. Clients say they want their advisor backed by a team and a majority say the prefer a diverse team with whom they interact.	**Emphasize a niche.** Solo and duo advisors serving a narrowly defined market niche can use digital technology to demonstrate their expertise and appeal to a national customer base. Through specialization, small firms greatly increase their potential to serve diverse segments of the population. A focus on families with special-needs children and specialized types of small business owners are some examples.
Widen recruitment. Consider candidates with a variety of skill sets. Look for young hires with strong credentials graduating from financial planning programs. Geography has become less important. Seek highly qualified talent from across the country. Be open to career changers who may have broad financial, sales or educational backgrounds presents opportunities to enhance DE&I efforts. Also consider candidates from outside the industry who have been involved in helping others — social workers, teachers, psychologists — you can train for the functions of the job, but it is much more difficult to instill a passion for caring.	**Join with another type of solo.** Older advisors tend to have older clients while younger advisors tend to serve younger clients. This presents an opportunity. In addition to providing the potential for business transition, combining younger/older solo practices can lead to diversity-friendly synergies, such as being more likely to serve the adult children of older clients. Combinations of smaller practices along different lines — male-female, planning-investing, retirement plan specialists and individual investor-focused advisors — also increase the potential for a more diverse customer base.
Expand training and set measurable goals. Require DE&I training of all staff and leadership. Many large firms already have this in place but for those RIAs that don't, there are a wealth of resources that you can find on-line. Beyond the training, make DE&I a core value of your business by creating goals for the firm or team and then aligning those goals with specific metrics and deadlines for achieving them. Every person in the firm should have goals related to building an inclusive culture. That may be hiring and employee development for management. While for younger staff it could mean joining industry affinity groups or being mentored by someone with a different background as them.	**Support more solo advisors.** An increasing number of advisors have observed unmet needs in the marketplace and are going solo. Encouraging more women, younger advisors and those of diverse ethnicity and race to go solo is another path to increasing diversity in the advice business. Independent broker-dealers, custodians, industry technology providers and others with a financial interest in the success of independent practitioners can help by increasing education and assistance to a new generation of diverse practitioners.
Consider a subscription-based approach to fees. Serving younger customers through subscriptions or time- and project-based fees — and with younger and more diverse advisors — can be a way to serve the adult children of older clients, expand a firm's client base generally and accomplish DE&I objectives by being able to reach out to a more diverse and often less affluent potential client base.	**Greater community outreach.** Time and effort spent on pro bono activities represents a true personal commitment. Whether a program involves speaking to church groups, at community centers, or to students in high school or college, a caring and informative financial advisor can profoundly change the course of someone's life for the better — which is the ultimate aim of financial advice.

STUDY DESIGN AND DEMOGRAPHICS AT A GLANCE

FINANCIAL ADVISOR RESPONDENTS

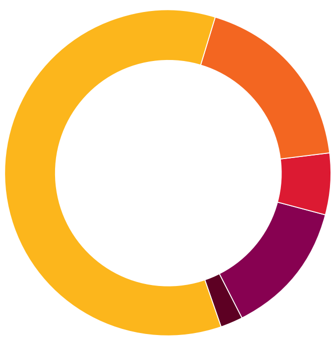
- White: **85.0%**
- Latino: **3.8%**
- Asian: **3.3%**
- Black: **2.0%**
- American Indian: **2.0%**
- Other: **4.5%**

15.5% WOMEN

84.5% MEN

A blind electronic advisor survey was fielded between 3/18/21 and 4/05/21. Results shown represent responses of 529 advisors.

CONSUMER RESPONDENTS



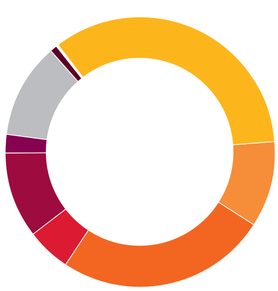
- White: **60.0%**
- Latino: **18.5%**
- Asian: **6.0%**
- Black: **13.5%**
- Other: **2.0%**

30% WOMEN

70% MEN

A blind electronic investor survey was fielded between 3/16/21 and 3/31/21. Results shown represent responses of 200 consumers with household incomes of $100K+ or higher, investable assets of $100K or higher. Median assets $500K to $750K. Assets excluded qualified retirement plans and primary residence.

ADVISOR FIRM TYPE



- RIA: **34%**
- Hybrid RIA: **11%**
- Independent Broker/Dealer: **25%**
- Insurance Broker/Dealer: **5%**
- Regional Broker/Dealer: **10%**
- Bank/Trust: **2%**
- Wirehouse: **12%**
- Other: **1%**

HOW FINANCES ARE MANAGED

57% I manage my own finances on my own or with the help of friends/family/etc.

43% I work with a financial advisor.

Resources are available

Visit go.flexshares.com/diversity to access a series of related podcasts and articles on different facets of building a diverse, equitable and inclusive advisory firm.

Also check out DE&I resources from these industry groups:

- The Certified Financial Planning Board
- The Investments and Wealth Institute
- The National Association of Personal Financial Planners

ENDNOTES

1 Baghai, P., Howard, O., Prakash, L., Zucker, J. (2020, July 29). Women as the Next Wave of Growth in US Wealth Management. McKinsey & Company.

2 FEDS Notes. (2020, September 28). The Federal Reserve.

3 National Center for Education Statistics. (2019). U.S. Department of Education.

4 Weeks, J. (2013, November 13). Weeks Population.

5 Distribution of Household Wealth in the U.S. (2021, March 19). The Federal Reserve.

6 National Population by Characteristics. (2019). U.S. Census Bureau.\

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