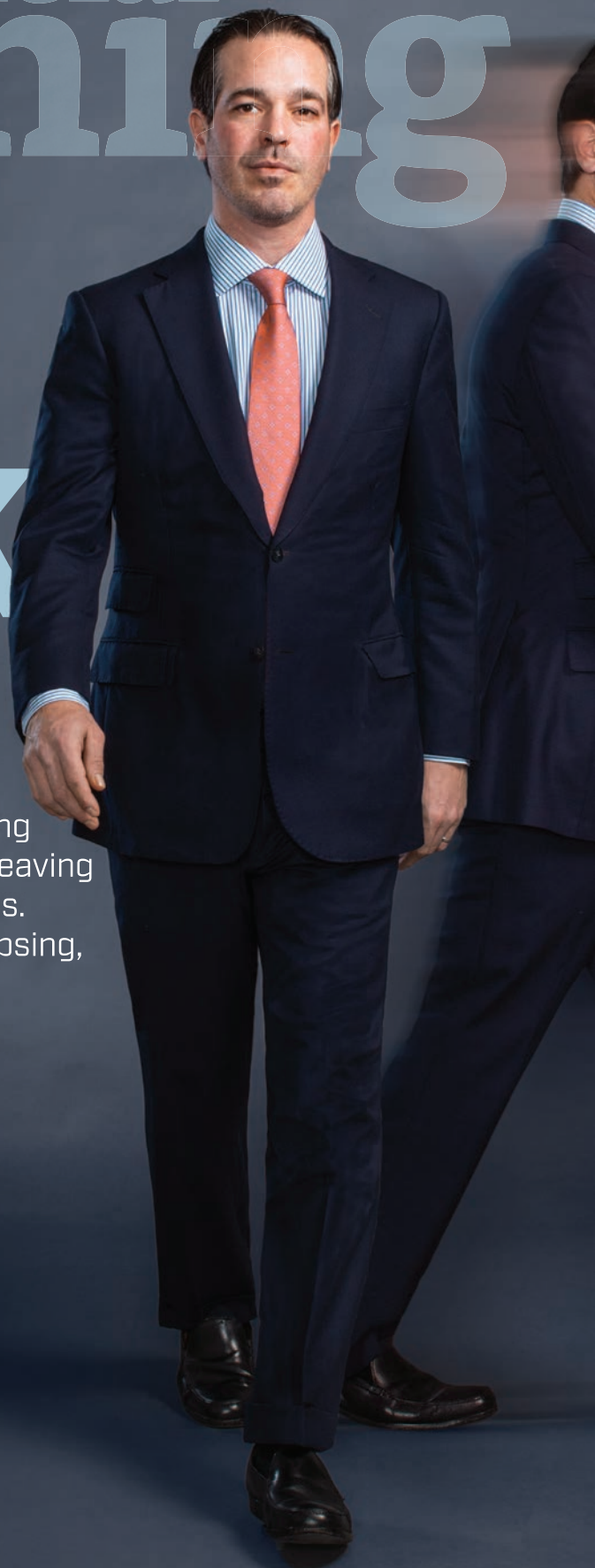


Financial Planning

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BREAK AWAY

Advisors like Greg Hersch have long found professional fulfillment by leaving wirehouses to start their own firms. But with the Broker Protocol collapsing, will they find that path cut off?





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2 Password management

Passwords can change on a regular basis, and remembering whether to use a question mark or exclamation point can be a bother, to say the least. Having a safe place to store your passwords and easily access your various accounts is crucial. Check out these tried-and-true service providers:

Dashlane: A password management application and secure digital wallet, this app is available on Mac, PC, iOS and Android. Dashlane's premium feature enables users to securely sync their data among an unlimited number of devices on all platforms.

LastPass: A free password management service that stores encrypted passwords in private accounts, LastPass includes plugins for many browsers and apps for a variety of smartphones.

3 Document signing

Spare yourself and your clients the unnecessary meetings when all you need is a quick John Hancock. Utilizing a secure service, such as eSignature at Raymond James, you can capture client signatures paper-free and remotely.

4 Scheduling tools

While some prefer the old pen-to-paper method, using an online calendar that you can access from any computer or mobile device can streamline your planning and ensure your calendar is up to date and even sharable, making it easier for others to see when you're busy or free and to plan meetings and events without the back-and-forth logistics.

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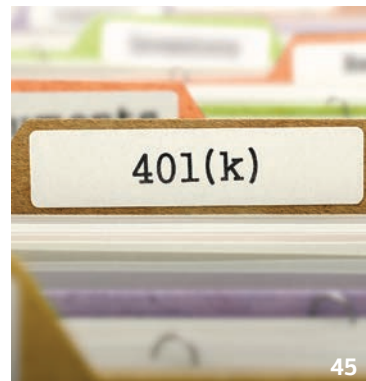
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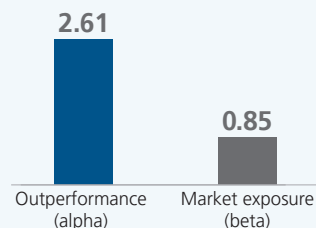
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¹ For each managed product, including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts, with at least a 3-year history, Morningstar calculates a Morningstar Rating™ based on a Morningstar Risk-Adjusted Return that accounts for variation in a fund's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. Exchange-traded funds and open-end mutual funds are considered a single population for comparative purposes. The top 10.0% of funds in each category, the next 22.5%, 35.0%, 22.5%, and bottom 10.0% receive 5, 4, 3, 2, or 1 star(s), respectively. The overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its 3-, 5-, and 10-year (if applicable) Morningstar Rating metrics. The rating formula most heavily weights the 3-year rating, using the following calculation: 100% 3-year rating for 36 to 59 months of total returns, 60% 5-year rating/40% 3-year rating for 60 to 119 months of total returns, and 50% 10-year rating/30% 5-year rating/20% 3-year rating for 120 or more months of total returns. Star ratings do not reflect the effect of any applicable sales load. As of 12/31/17, the fund was rated 5, 5, and 5 stars out of 847, 778, and 554 intermediate-term bond funds for the 3-, 5-, and 10-year periods, respectively. Please note that Class I shares may not be available to all investors and that performance of other share classes may vary. Past performance does not guarantee future results.

² Morningstar Direct. Calculations are based on Class I shares for the 10-year period ended 12/31/17. Alpha measures a manager's incremental return that cannot be attributed to market movements. Beta measures the sensitivity of the fund to its benchmark. The beta of the market (as represented by the stated benchmark) is 1.00. Accordingly, a fund with a 1.10 beta is expected to have 10% more volatility than the market. The fund's benchmark is the Bloomberg Barclays U.S. Aggregate Bond Index, which tracks the performance of U.S. investment-grade bonds in government, asset-backed, and corporate debt markets. It is not possible to invest directly in an index.

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16 TRENDS TO WATCH

Compliance 2018



Don't Snooze on Compliance Issues

Regulatory oversight has steadily increased since the financial crisis and advisors should only expect the supervision to grow, says compliance consultant Todd Cipperman. Wealth management firms should spend at least 5% of their revenue staying up to date with new regulations, he suggests. Even though the fiduciary rule has been delayed, advisors won't be off the compliance hook anytime soon, he says. See our slideshow: <http://bit.ly/2meGbqC>

The Near Future of Digital Investing

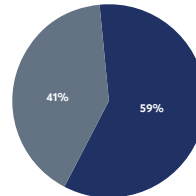
More than 40% of investors now use some combination of human and digital advice, according to research from consulting firm Hearts & Wallets. "The term is going to be decreasingly useful," says the firm's CEO, Laura Varas. New industry entrants may tailor their strategy to the finest client minutia like levels of investing experience and whether clients like to think about their savings goals, she says. Use this link to read more about emerging digital trends: <http://bit.ly/2CEZZcR>

GUIDE TO GROWTH

Taking a hybrid approach

Clients are combining traditional and digital advice platforms.

- Hybrid, 41%
- Traditional, 59%



Source: Hearts & Wallets



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EDITOR'S VIEW

The Tough Questions

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WHY HAVEN'T WE HEARD MORE ABOUT SEXUAL HARASSMENT IN THE wealth management industry?

Amid countless, heart-wrenching accounts about the personal anguish and professional setbacks caused by unwelcome sexual behavior in the entertainment, media and manufacturing industries, I've been asking men and women in financial services this question.

Many have said something along the lines of what *Financial Planning* contributor Carolyn McClanahan writes in "Hit 'Reset' on Firm Culture," on p. 34: Much of the abusive conduct in the industry was addressed or went underground after a slew of well-publicized cases in the 1990s.

But it hasn't gone away. What's more, I doubt it ever will. That means it's more important to ask a different question: What will we do to assure more women and men are treated with respect in the workplace? While there is a long way to go, I've been encouraged to see some firms and executives take action.

For one, Fidelity CEO Abigail Johnson moved her office to the same floor where key equity portfolio managers, analysts and traders sit, after two fund managers left following allegations of inappropriate behavior.

Edward Jones has set a goal of increasing its women advisors workforce to 50% from about 19%, which, if successful, could help offset the power imbalances that allow some executives to get away with sexual misconduct.

And Advisor Group CEO Jamie Price tells me the firm is exploring how to share its C-suite level training and education with its advisor network.

Still, there's much more progress to be made, and it will come with renewed, honest and unblinking examination.

When you look around your firm, have you done everything you could to root out and prevent possible sexual harassment? Asking this and other tough questions is just the beginning. —*Chelsea Emery*



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RETIREMENT ADVISOR CONFIDENCE INDEX

Confidence Soars With Stocks

Clients are bullish on the economy and equities, advisors say, but worries about an eventual stock market downturn remain.

CLIENT CONFIDENCE HAS CLIMBED, AND A rosier outlook about the economy and stock market is propelling robust flows into equities and retirement accounts, advisors say.

Allocations to stocks rose sharply, according to the latest Retirement Advisor Confidence Index – *Financial Planning's* monthly survey of wealth managers – and helped support further improvement in business conditions for the investment industry.

The component measuring the amount of client assets used to buy stocks and stock funds increased 5.1 points to 66.4. Readings above 50 indicate expansion, while readings below 50 indicate contraction.

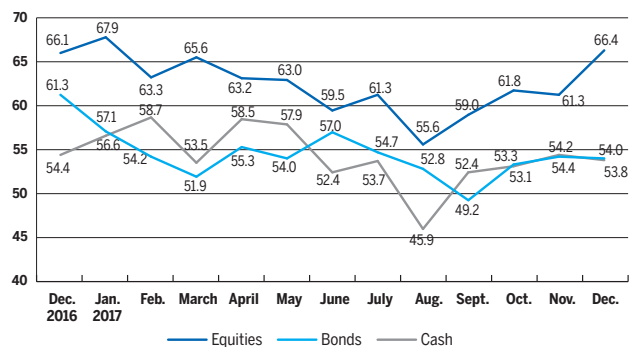
“People are more confident about the economy and more willing to invest in stocks after a great 2017,” one planner says.

The upswing in the equities flow component was one of the biggest factors behind a 2.7-point increase in the composite RACI to 57.1 – its highest level in more than a year. The composite tracks asset allocation, investment product selection and sales, client risk tolerance, tax liability, new retirement plan enrollees and planning fees.

Advisors attribute the confidence in part to reassuring economic fundamentals and growing comfort with the high returns stocks have delivered. “Clients are more optimistic based on gains,” one planner says.

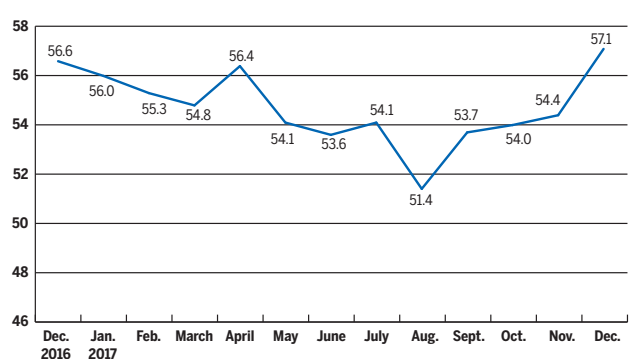
Planners also say the tax overhaul helped improve sentiment. “Though some feel that the tax plan was already ‘baked’ into the market, others felt it would be

ASSETS ALLOCATED TO EQUITIES, BONDS AND CASH



Source: SourceMedia Research

RETIREMENT ADVISOR CONFIDENCE INDEX



Source: SourceMedia Research

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positive and lead to higher profits,” one advisor says.

Worries that risks are building continue, however. One advisor says, “The No. 1 question I’m getting in every meeting is: When do I think the market will either crash or have a serious sell-off?”

Planners report they are urging clients to resist both overreacting to fear of potential losses and the temptation to invest too aggressively. “We have been counseling everyone to maintain their previous risk tolerance unless their circumstances have changed,” one planner says.

Nevertheless, some planners say they are positioning clients to take advantage of bargains that may appear during future periods of volatility. One advisor reports “significant selling” of U.S. stocks “to raise cash for potential future investment opportunities, which so far remain unknown.”

Overall, the RACI component measuring client risk tolerance jumped 6.2 points to 62.8, its highest level in a year.

Wealth gains from strong market performance, combined with year-end financial planning, led to strong flows into retirement accounts, with the RACI component tracking the dollar amount of contributions to retirement plans jumping 8.6 points to 69.3. That level surpassed even last April’s mark of 67.5. Tax time is typically the seasonal high for retirement contributions.

The latest RACI, which is based on advisors’ assessment of conditions in December relative to November, is accompanied by the quarterly Retirement Readiness Index.

This index tracks advisors’ evaluations of their clients’ income-replacement ability, likely dependence on Social Security and exposure to large economic shifts.

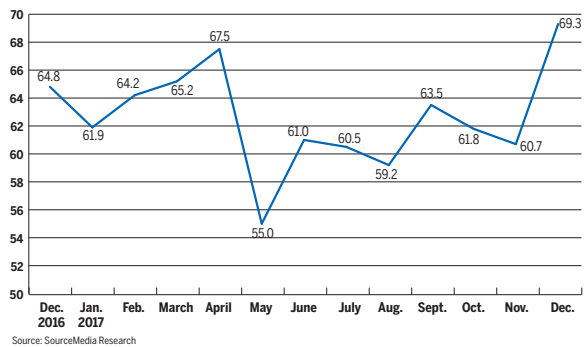
Advisors say that the vulnerability of mass-affluent clients (net worth of \$250,000 to \$1 million) to a range of potential economic shocks has dipped a bit, but that the threat of a significant increase in health care costs still looms particularly large.

About 34% of advisors say such a shift would be extremely damaging to mass-affluent clients’ retirement security. “It is

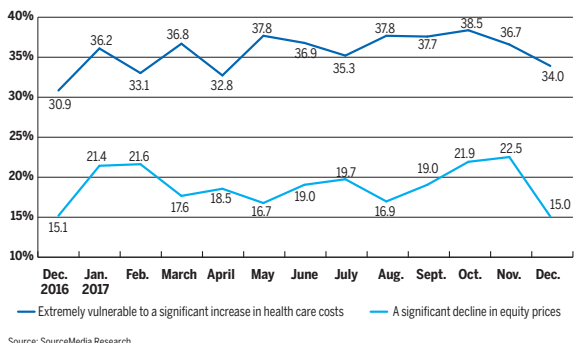
tough to understate the uncertainty associated with health care cost risks,” one advisor says.

Overall, advisors expect close to 60% of mass-affluent clients will be able to replace their income for 30 years in retirement. This is compared with 74.8% of high-net-worth clients (\$1 million to \$10 million) and 80.4% of ultrahigh-net-worth clients (more than \$10 million). — *Harry Terris* **FP**

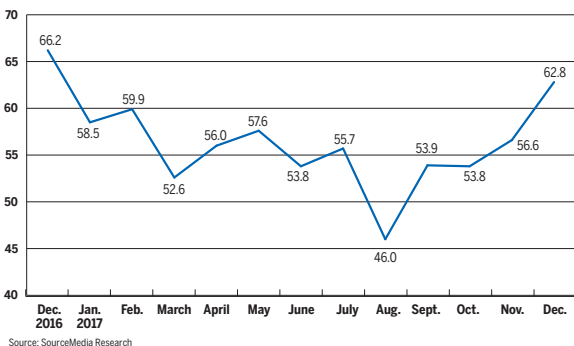
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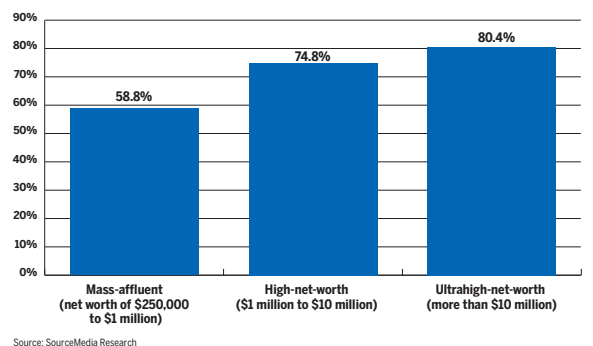
MASS-AFFLUENT RETIREMENT READINESS



CLIENT RISK TOLERANCE



ABLE TO REPLACE INCOME AT RETIREMENT





INDUSTRY INSIGHT **VERES**

Chief Obstacles to Progress

Flawed human behavior may impede planning firms' ability to take advantage of tech innovations, Bob Veres says.

HERE'S A QUESTION THAT I'VE BEEN hearing a lot lately: What will drive the biggest changes in the planning profession?

When I look at the tech landscape from a historical perspective, it's easy to be amazed. I remember when software was first introduced into the profession (am I dating myself a bit?) and when planners were buying their first 8086 computers, those large boxes complete with disk drives.

Push a button and a dot matrix printer would spit out a 40-page canned document that included net worth statements and future projections of client account values 30 or 40 years in the future, down to the penny – along with portfolio designs and recommendations. Think of it as Robo 1.0.

GALAXY OF SHINY TECH

We now have a galaxy of bright, shiny technology, all of it potentially available on the phone you carry in your pocket. You can talk to your computer and it performs functions or searches. If you don't like the keyboard, just touch the screen.

The next Intel computer chip will have the processing power of the human mind, and quantum computing is not far behind.

So which of these exciting new developments do I think will make the biggest technology impact on financial planning firms going forward?

None of them.

The biggest impact, in my view, will

come, as always, from changes (sometimes painful) in human behavior.

The real challenge in the profession today is clearly not limitations on technology or innovation; just walk around the T3 exhibit hall and you will see plenty of new products coming at us every year.

We have finally come to the place where we realize there is nothing to fear from disruptively creative programs that automate tasks that planners have traditionally done by hand.

It is no longer regarded as a mortal threat to your service model if computers do some things that clients have traditionally found valuable (creating tailored asset allocations, for instance) as well or better than you do.

I don't know what tech will bring us tomorrow, much less 10 or 15 years in the future. But I know that today, and every year going forward, the biggest key to unlocking all those capabilities will be how well planning firms adapt to them.

Humans are the limiting factor. Their ability to overcome their own limitations will have a far bigger impact on the profession than whatever tools our most creative software engineers develop.

RESISTANCE TO CHANGE

There are several components to this. The most obvious is resistance to change. The old adage "If it ain't broke, don't fix it" no longer applies. When I talk with (primarily

Humans' ability to overcome their own limits will have a far bigger impact on planning than whatever tools our most creative software engineers develop.

younger) advisors, the first thing they bring up is how the company founders are resisting the obvious benefits of switching from legacy software to something faster, newer and better. The senior advisors are comfortable with their current systems, procedures, inputs and interfaces, even if they require a lot of manual entry and hand-made calculations.

In some cases, the founders are even resisting the latest upgrade, because it means they will have to change their old, comfortable habits. The good ol' spreadsheet is good enough for them.

The second piece is adoption. It's not uncommon to hear software vendors say their average customer uses only a small fraction of the capabilities their system provides. People still use the CRM as a Rolodex in the cloud, instead of as a total practice management tool with handy compliance features.

If every advisory firm simply stopped for a moment and spent the time and money on better internal training, getting the full value of what they already have, the profession as a whole would experience instant leaps forward in productivity and service.

ADVANCED COMMUNICATION

The third human element that is holding back our tech evolutionary process is integration. Most of the name-brand software programs provide levels of communication that would have astonished the most advanced techie just five or 10 years ago. We have single sign-on where you can work with any program from any other one, just by clicking an icon in the upper-right-hand corner.

With some custom programming, it is now possible for one piece of software to trigger processes in other tech solutions.

As a simple example, when you sign up a new client, the system can automatically populate, prepare and print out (in PDF or paper form) the new client agreements, and communicate with the custodian's central database to retrieve pre-populated ACATS forms.

You can update a financial plan through changes in the client record in the portfolio management or CRM system.

But before it can get the full benefit of these integrated processes, the firm needs to define its systems and procedures internally. At most of the firms I talk to, there are still a lot of one-off behaviors that, by definition, cannot be programmed into a software system. When you're reinventing the wheel with every single client task, you are forgoing all the benefits technology was intended to provide.

It's possible that we, as a profession, will never get the full benefit of the new tech solutions. New ones are coming at us faster than we can track, and it obviously doesn't make sense to change over your entire software suite every two or three years just because new capabilities are introduced by new providers.

MANAGING BUILT-IN OBSTACLES

If we could defeat these built-in obstacles to intelligent tech adoption – that is, succumbing to all-too-human inertia and the willingness to settle for a “good enough” solution that's increasingly behind the times; avoiding looking at the marketplace because it presents you with a bewildering amount of choice; buying shiny new software programs and never spending the time or money to get the staff using more than 15% of them; or not being willing to go through a painful process of rethinking and streamlining business procedures so technology can do more cheaply what humans do expensively – it would make a far bigger difference to the profession's productivity and service than the coolest AI robo on your smartphone.

Technology can only do what we allow it to, and right now I don't think we, as a profession, are being very permissive.

The biggest disruption I see on the near horizon is that a handful of firms will figure out how to get the most out of what's offered, and intelligently upgrade to new software as it's developed.

Those firms that master the human side of technology are going to enjoy a huge advantage over the others, and truly drive change in the profession.

FP

If every advisory firm spent the time and money on better internal training, getting the full value of what they already have, the profession as a whole would experience instant leaps forward in productivity and service.

Bob Veres, a *Financial Planning* columnist in San Diego, is publisher of Inside Information, an information service for financial advisors. Visit financial-planning.com to post comments on his columns or email them to bob@bobveres.com. Follow him on Twitter at [@BobVeres](https://twitter.com/BobVeres).



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ELITE ADVISOR **BOWEN**

Private Events That Pay Off

You may hold a superb session for clients and prospects, but it won't matter if you don't achieve what you actually set out to do, John J. Bowen Jr. says.

PRIVATE CLIENT EVENTS CAN HAVE a strong impact on the success of your practice, helping you build credibility with existing clients while also attracting new business. And yet, these types of organized events are overlooked or implemented poorly by many advisors.

Understand that these events are different from the seminars or presentations you may be used to. Private events are designed to speak to a small group of select invitees who you truly want to work with.

Many of my firm's coaching clients have told us that the affluent prefer events that feel exclusive over big seminars that they feel are too mass market. So, try to limit your audiences to no more than 30 people to create an intimate, comfortable atmosphere. A smaller group also will give you more opportunities to address questions from the audience and make personal contact after the presentation.

With that in mind, here are four techniques that elite wealth managers use to design and conduct high-quality private events that increase their top lines.

1. START AT THE FINISH LINE

Think about your ultimate end game before you get going. That way, you'll never lose

sight of your event's key purpose: generating a stream of prequalified, pre-endorsed prospects. Everything you do regarding your event needs to have a purpose.

We have seen some advisors spend a great deal of time creating terrific content and lining up amazing speakers for their presentations, while completely overlooking the key component: the follow-up – that is, the desired outcome they want to achieve by holding the event in the first place.

If you've ever conducted a presentation and felt a post-seminar letdown, you know

what I'm talking about.

After the warm glow of the backslapping and congratulations fades, you realize you didn't do any significant business.

Why? Because most advisors have only a vague idea of the big picture – more clients – and they get so caught up in the event that they forget why they're there.

To avoid this classic mistake, plan out your event marketing series for the next 12 months, starting with the results you want to achieve and moving backward from there to the actual event. For wealth managers, the focus should be on one action: getting qualified prospects to attend introductory meetings where you can provide them a second opinion on their financial situation.

Try to limit your audiences to no more than 30 people to create an intimate and comfortable atmosphere.

Video

Follow these four steps to create great client events.

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2. KNOW YOUR AUDIENCE

As you turn to the task of designing the event itself, keep in mind that at each event you will probably have three types of attendees and that you should set specific goals for each type.

- **Clients.** Your goal with existing clients is to solidify the existing relationships and to continue to reinforce that you are the go-to expert for meeting their needs.

- **Prospective clients.** Your goal with this group is to allow them to “test drive” you in a comfortable environment where they do not have to make a commitment.

- **Other professionals.** With strategic partners or members of your expert team who attend events, you have two goals. The first is to cultivate joint business development opportunities. The second is to have these partnering professionals see you through the eyes of clients and prospective clients. You want them to see the impact that your insights and communication skills

have on attendees.

3. MARKET INTELLIGENTLY

Send invitations to your events only to existing clients or to individuals who are qualified for your service. You have three fertile sources for these qualified individuals:

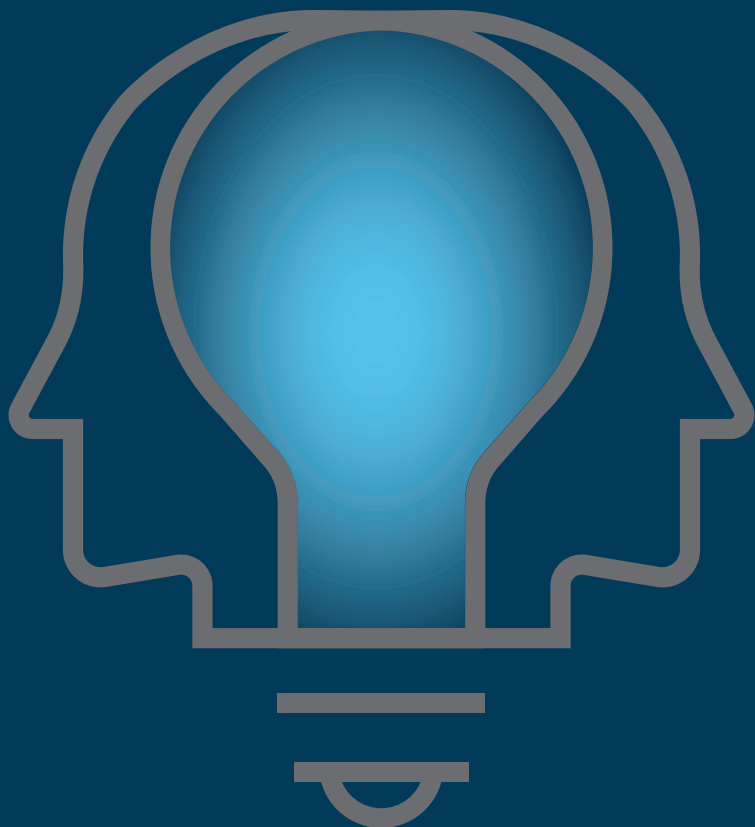
- **Existing clients.** When you invite your ideal clients to your events, invite them to bring along their affluent friends.

- **Strategic alliance partners and your expert team members.** Clients of your strategic partners and expert team members should be invited to your events.

Depending on your arrangement, invitations should be sent out directly from your partner or team members or jointly by both of you. These clients should also be welcome to invite friends and associates.

- **Affinity groups in your niche.** Affinity groups are any associations, clubs or other organizations of people who share a common interest or goal.

Don't use prepackaged seminars as they often appear off-the-shelf and won't position you as an expert in your specific market.



A lot of thought went into this

No Br

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The leaders of many of these groups are always looking for ways to add value to their members – something you can provide through your events – and will be willing for you to invite members.

4. CREATE A 'WOW' PRESENTATION

Your content should tackle the concerns and issues of your niche in ways that capture the attention of the audience and that show them that you are *the* wealth management expert for that niche.

In today's environment, this may mean a presentation on the major areas that affluent investors are concerned about – such as protecting wealth, mitigating taxes, taking care of heirs, protecting assets from being

unjustly taken through litigation or divorce, and charitable gifting.

Another way to ensure a wow presentation is to make it action-oriented. Hand out blank personal action summaries to all attendees.

As you present your content, encourage them to write down the actions that they feel they should be taking to address their financial issues.

This will make them more inclined to follow through on your invitation to meet with you for a second opinion. It will also remind them how much they have to do to manage their financial lives and will position you as the right advisor to help them.

Warning: Don't use prepackaged seminars here – even ones designed

to appeal to affluent investors. They often appear obviously off the shelf, and they do not properly position you as an expert in your specific market. If you have written any white papers or conducted retirement planning research, create presentations from this content and distribute the white paper as your handout, which can further enhance your credibility among attendees.

Private client events aren't the key to success for every advisor out there, of course. But if you enjoy public speaking and work with a target market that attends such get-togethers, you will find that these events help you stand out and position you as a go-to advisor among the people you most want to serve. **FP**

John J. Bowen Jr., a *Financial Planning* columnist, is founder and CEO of CEG Worldwide, a global coaching, training, research and consulting firm for advisors in San Martin, California. Follow him on Twitter at @CEGAdvisorCoach.

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IN PRACTICE **FOSS**

Stamping Out Sexual Harassment

Here's how independent advisors can build a culture of zero tolerance for gender discrimination, Kimberly Foss says.

SEXUAL HARASSMENT IS NOT primarily about attraction – it's about power. Give more power to women, the reasoning goes, and sexual harassment gradually fades away. Unfortunately, this logic isn't always borne out. Consider Fidelity.

The Boston-based financial firm is led by several visionary and principled women, including its CEO Abigail Johnson and Kathleen Murphy, president of Fidelity Personal Investing, a unit with more than 12 million customer accounts and \$1 trillion in assets. Both women are included among *Fortune* magazine's Most Powerful Women.

But even with strong female leadership, Fidelity found itself in the throes of a sexual harassment scandal. In October, two senior male executives at Fidelity left for making inappropriate comments amid what some describe as a broader culture of sexual discrimination and bullying.

Fidelity isn't alone. Allegations of sexual harassment and class-action lawsuits have plagued respected Wall Street firms such as Smith Barney and Merrill Lynch over the past few decades. But the Fidelity controversy could hit closer to home for independent advisors, as the firm is a major provider of clearing, custodial and other services.

Fidelity says it has taken a number of steps to foster a respectful work environment, including creating a sexual harassment response committee. "As our CEO, Abby Johnson, has made clear, when alle-

gations of harassment or other inappropriate behavior are brought to our attention, we investigate them immediately and take prompt and appropriate action," Fidelity spokesman Vincent Loporchio says.

RED FLAGS

Harassment and outraged responses to it are not new, of course. In the 1980s, a male friend advised me that I would not be successful in the financial industry because of my gender, as I related in my book "Wealthy by Design." I wish that had been the worst thing that had happened. But it wasn't.

I remember the frantic feeling of studying for my securities licensing exams while running the gauntlet of simulations, training sessions and other exercises that were – and in many cases, still are – part of the onboarding experience for financial consultants.

After interviewing with other houses, I staked everything on going to work for Merrill Lynch. In the midst of this frantic time, I felt grateful when a regional manager offered to help me prepare for my exams. But not long after I arrived at his palatial residence, he began to try to kiss me ... and worse.

When I refused his advances and told him to call me a cab, he said that, if I left, I would never work for his firm.

I took a deep breath and said I would rather be out of a job and still have my personal integrity intact. Thankfully, I was able to get in the cab and leave.

Empowerment that comes from running your own shop can provide a wall of protection from those who would unfairly use superior positions as leverage.

Merrill Lynch declined to comment last month about the incident.

Years of similar incidents, many of which ended much worse than my own story, have forced major firms to establish guidelines, protocols, hotlines and no-tolerance policies regarding sexual harassment and misconduct. And yet, even after all these years, the problem is still rampant.

A young associate of mine who worked previously at another large firm told me recently that the culture is still uncomfortably similar to what I experienced all those years ago.

CONCRETE STEPS

Here are four concrete steps independents can take to help change the culture:

- Opening up the top ranks of management to women will ultimately advance the campaign for a harassment-free workplace. As the current problems at Fidelity suggest, this is certainly not a cure-all, but there is room for improvement. Moreover, a recent GAO study indicates that women have made little or no progress toward increasing their presence in the industry since 2007.

- The independent financial planning industry must continue to press for zero tolerance of sexual misconduct of any type. Unfortunately, sexual harassment and gender bias is not limited to specific firms or workplaces; advisor conferences can become hubs of unwanted comments, attitudes and activity.

"I would walk through exhibit halls as a planner and I would be asked whose assistant I am. Why did [they] assume that?" asked Breanna Reish, an experienced planner who recently launched her own firm, according to a recent news report.

The 2017 Dallas conference of the XY Planning Network, a group of fee-only advisors who specialize in Gen X and Gen Y clientele, opened with the announcement of

a code of conduct that prohibits any form of discrimination or harassment.

"Sexual language and imagery is not appropriate for any conference venue, including talks, workshops, parties, Twitter or other online media," the code read. The app for the conference even included a function that facilitated the reporting of inappropriate conduct.

PROMOTE DIVERSITY

YYPN also offered a networking track focused on women advisors.

The group has formed its own diversity committee, and it is dedicated to helping member advisors promote diversity in their firms and practices. Such initiatives are an important beginning and other firms need to join the movement.

- We should embrace the adage that was popularized by the British Transport Police in their campaign against terrorism: "See it. Say it. Sorted."

The Harvey Weinstens of the world cannot systematically victimize unless bystanders look the other way. We need to stare sexual harassment in the face and call it what it is.

- Finally, we must listen and believe in the voices of women and others who have been silenced for too long. It is very difficult to speak truth to power – especially when the speaker has suffered the abuse of that same power.

We need to take up the cause of those who have been wronged. When they talk, we need to listen and take action.

For years, independent financial advisors have been leading the way in providing reasonably priced services with a commitment to the client's interests above all.

It is time now for us to lead the charge to eradicate all forms of sexual harassment and gender discrimination from the financial industry.

The Fidelity controversy could hit closer to home for independent advisors, as the firm is a major provider of clearing, custodial and other services.

To learn more about creating a respectful work environment, please see p. 34.

FP

Kimberly Foss, CFP, CPWA, is a *Financial Planning* columnist and the founder and president of Empyryon Wealth Management in Roseville, California, and New York. Follow her on Twitter at @KimberlyFossCFP.



PRACTICE CONSULTANT **KAUTT**

Past Lessons for Future Growth

Reviewing prior academic and industry research can unveil compelling insights on how to succeed now, Glenn G. Kautt says.

TWO DIFFERENT YEARS-OLD REPORTS

from industry researchers and the academic world offer predictions and analysis that are surprisingly suited for today's world. And the current generation of decision-makers would be wise to heed those lessons.

Harvard University business historian Alfred Chandler wrote "The Visible Hand" in 1977, taking his cue from the invisible hand concept Adam Smith introduced in the "Wealth of Nations" two centuries earlier.

Chandler's book described how the definable, controllable factor of management exerted a more powerful influence than free-wheeling, invisible market forces. He showed that managers running large enterprises exerted greater influence in determining size and concentration in American industry than capital or market forces.

With Chandler's findings in mind, I researched our industry and considered my business future. First consideration was another report from a mutual fund called Undiscovered Managers that forecast a decline in profit margins and consolidations. (Undiscovered Managers sought out unappreciated businesses initially, and has evolved into the Undiscovered Managers Behavioral Fund, which selects small-cap stocks based on behavioral finance factors.)

I was struck by several things in their report. First, the principal author was bright, focused and well-educated. Also, the report's message was in agreement with the findings

of a long line of research on business evolution, including Chandler's assertion about the power of management in dealing with business challenges.

Still, the report ignited a firestorm of controversy at the time because it stated profit margin compression, firm consolidation, the emergence of niche practices and a host of financial woes for small practices were coming. Today, the same forces are still at work.

Undiscovered Managers followed up a year later with a prescriptive report, including their recipe for success: Find a niche or get big. The whole thing sort of disappeared after that, but that does not mitigate the overall message for today's businesses.

ANALYZING PROFIT MARGINS

A substantial amount of business research shows maximum profits depend on business strategy, organizational structure and where the firm fits in the marketplace.

But knowing the difference between strategy and operations is key. Attempting to improve service quality and reduce the cost of that service fall under operational effectiveness (moving from A to B on the Strategy vs. Operations chart). On the other hand, the decision to offer high-quality service at a high price or lower quality service at a lower price is a strategic positioning choice (moving from P to Q on the chart).

Think of your business as an investment portfolio, where you're striving to position

Think of your business as an investment portfolio, where you're striving to position it on the edge of the efficient frontier.

it on the edge of the efficient frontier. Some decisions move you around, toward that frontier or away from it. Simply put, you can't operate two very different businesses optimally using the same operational model.

Expecting higher profits without understanding where you are in your marketplace is a waste of time. Analyzing profit margins must be done in the context of your organizational structure and profitability drivers. Different organizational models with different profit margin structures will work fine — if you know which one is right for you.

Competition will force the inexorable drift from firms that once practiced cutting-edge operation to becoming commoditized. If your firm continues to do the same thing year after year, you'll find yourself becoming less competitive and profitable.

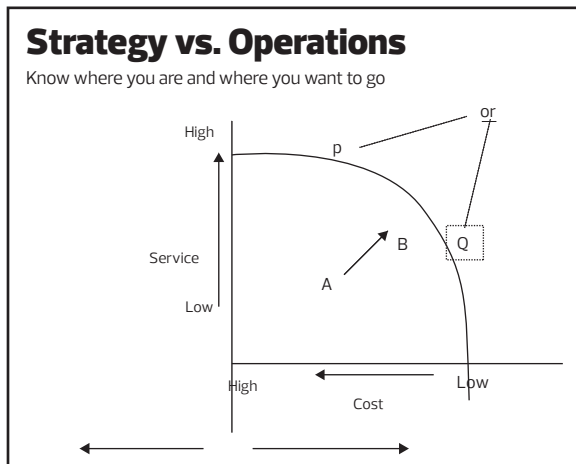
- We realized we could not compete as high-margin or high-volume using the same organization.
- We saw that doing nothing would start our drift to becoming commoditized.

After that bit of self-analysis, here was our reaction. We made a long-term strategic decision to stay in the forefront of the industry technically and intellectually. Our advisors would become experts, publishing professional contributions in journals and white papers based on solid research.

Then we'd share our expertise by writing and speaking about it. We made clients and prospects aware we were recognized experts, backing that up with practical application of our skills. And we added more services such as 401(k) services and tax preparation as stand-alone profit centers, and

less-costly/less-sophisticated services for smaller clients in another profit center.

If your firm continues to do the same thing year after year, you'll find yourself becoming less competitive and profitable.



Maximum profits depend on business strategy, organizational structure and where a firm fits in the marketplace.

GET REAL

Our industry continues to change. These changes are typical of every maturing industry, and there's not much you can do about the big trends. But, there is plenty you can do with your business to take advantage of these changes if you realize where you fit in the marketplace and operate accordingly.

To do so, you need to get very real with your business. Hire an expert to help determine where you are in the marketplace and where you should be heading.

Next, consider how to get there. "Should you be moving from a Q to a P firm, or focus on moving from A to B on the chart? Should you consider combining with another firm to change more quickly?"

And bear in mind, it is your total profits, not profit margins, that are important. Take a lesson from the past: How you increase profits depends on company organization, which depends on your strategic goals and vision for your business.

FP

Here's what we decided at our firm:

- Studying industry surveys, we recognized we were above average margins for our industry.
- We confirmed how we operate in the financial planning market: an established, knowledgeable firm based on a comparison of our company's operating practices and financial characteristics.
- We understood we could not compete with the high-volume/low-margin firms unless we changed organizationally to be exactly like them.

How RIAs Can Access Capital

Investment capital has become widely available, but advisors still face challenges in deciding what they need and who should provide it.

BY CHARLES PAIKERT

INVESTMENT CAPITAL HAS BECOME EASILY available for RIAs, but that doesn't mean advisory firm owners have free rein over the cash register.

"The industry is awash with capital," Rich Gill, co-founder of Wealth Partners Capital Group, a newly formed RIA aggregator, said at MarketCounsel's annual conference for advisors, in Miami Beach, Florida. "Finding the appropriate partner and structure can be challenging, but the money is certainly there."

Industry executives noted that private equity firms, private investors, family offices, aggregators, banks and even sovereign funds are investing capital in RIAs. So how can advisors best tap these newly available resources?

- **Determine what kind of capital you want to use.**

Advisors who borrow money using credit can take advantage of low interest rates, but also "assume a certain level of risk," Gill pointed out. Capital coming from equity investors needs to be closely scrutinized, he added.

- **Know what motivates providers.**

Lenders have a return expectation of 5% to 10%, while equity investors are looking for a mid-teen to 20% return on their investment, said Shirl Penney, chief executive of Dynasty Financial Partners, the New York-based platform provider. Private equity firms typically have a short-term investing time horizon, and some RIA buyers may want distribution access to cross-sell other products, Penney added.

- **Recognize why you want the capital.**

Advisors typically need capital to provide liquidity for shareholders, to invest in the business, make acquisitions or fund a succession plan. "Advisors have to look in the mirror," Gill said. "Determining where you are in your career and what you want to do can make a big difference in what kind of deal you want to make. If you feel you have five good years left, that's going to mean a different decision than if you feel you're just hitting your stride."

- **Know what capital providers value.**

"Assets are an incredibly poor proxy for the value of the



Rich Gill, Marty Bicknell, Shirl Penney and John Furey spoke with advisors at MarketCounsel's annual conference about how an RIA should go about finding the right investment partner.

business," Gill told the assembled advisors. "As a buyer, we're only looking at revenue, free cash flow, profit and loss and balance sheet strength."

Marty Bicknell, chief executive of Leawood, Kansas-based Mariner Wealth Advisors, which has over \$10 billion in AUM and plans to accelerate its inorganic growth in 2018, said an advisor's "only value proposition is client engagement. The only thing that matters is working closely with your clients, keeping them and gaining more."

Advisors shouldn't be seduced by asset growth as a result of the bull market. "Growth has to be uncorrelated to the market," he stressed. "You want to add net new revenue."

- **Fix things that need fixing.**

Start preparing early, fix things that need fixing and reinvest. "Advisors need to reinvest in the firm, especially if they're hitting a plateau where they can go to the next level," Gill said. "Invest in advisors, operational staff, professional managers and technology. It's hard to do but best for the business."

The more cash that principals reinvest, the more valuable the business becomes, John Furey, principal and founder of Phoenix-based Advisor Growth Strategies, told the advisors.

"Run the business like you don't need other people's money," Penney added. "The best time to raise capital is when you don't have to."

• **Consider hiring an investment banker, despite the expense.**

Investment bankers aren't cheap, but

they will significantly reduce your workload, said CEO Elliot Weissbluth, chief executive of HighTower Advisors. "Investment bankers are like air traffic controllers," Weissbluth said. "They remove distractions and manage the process and timeline."

• **Don't be afraid to walk away.**

Sometimes a deal just isn't meant to be.

"The best deals I ever made," said Peter Raimondi, who engineered five transactions in seven years as head of Banyan Partners, "were the ones I didn't make." **FP**

"Assets are an incredibly poor proxy for the value of the business," says Rich Gill of Wealth Partners Capital Group.

What's Driving Valuations?

As RIAs seek to make themselves attractive to possible acquirers, they should focus on elements that are most valuable to buyers.

BY CHARLES PAIKERT

EXACTLY HOW RIAs ARE VALUED IS MORE relevant than ever in a red-hot market. Vic Esclamado, managing director at DeVoe & Co., says there are three drivers of value RIAs can't afford to ignore: growth, cash flow and risk.

Speaking to RIA owners at the firm's inaugural M&A conference after the MarketCounsel Summit, Esclamado stressed the importance of focusing on what's really valuable to buyers when prepping a firm for a sale.

1. GROWTH

Solutions for growth, especially when measured by revenue, EBITDA and net new client assets, "may take the longest to implement but deliver the longest-term benefit," Esclamado said.

RIAs shouldn't be afraid to spend money to hire business development specialists, he said. "It's critical to identify the right people to represent the firm, make calls and get new business," he explained.

Firms should also apply to join referral programs offered by custodians. "RIAs can increase their leads, improve their branding and get in front of more prospects," he said.

Firms should also create "a comprehensive and integrated marketing approach that will drive sustained growth," DeVoe & Co.'s founder, David DeVoe, said in an interview with *Financial Planning*. "It is a growth machine that is important — not a single silver bullet or charisma.

2. CASH FLOW

Carefully measuring expenses and revenue offers RIAs "a rich benchmarking opportunity," Esclamado said. How owners are compensated is one aspect of cash-flow analysis that is often overlooked by sellers, he added.

For instance, many owners simply "take home a certain amount of cash" and don't separate that amount into a base salary and proceeds from the business, Esclamado said. But that's a mistake, he argued. "Potential buyers want to see a standardized compensation structure," Esclamado said. "Normalizing comp is a big deal."

Buyers also pay close attention to profitability, added DeVoe. "Running a profitable firm not only creates more income for the owners, it demonstrates you are running a well-managed organization," he explained.

3. RISK

Tackling risk is "the lowest hanging fruit for increasing firm value," Esclamado said. In hiring advisors, firms should include noncompete and nonsolicit provisions.

Every firm should have a succession plan, Esclamado said. "Key-man risk is something every buyer looks at," he noted. "Having a succession plan in place is essential."

An independent board of directors made up of successful executives from outside the industry is another way RIAs can reduce risk, said Brent Brodeski, CEO of Savant Capital Management in Rockford, Illinois. **FP**

Charles Paikert is a senior editor of *Financial Planning*. Follow him on Twitter at @paikert.

HIGH NET WORTH

Dangerous Generalizations

The drastic changes under the new tax law are shaking up the status quo of estate planning. Here's how planners need to change their approach.

BY MARTIN M. SHENKMAN

TOSS ROUTINE PLANNING RIGHT OUT THE WINDOW.

Now that the status quo of tax planning has been upended by the enactment of the tax overhaul, wills, trusts and portfolios are all due for a once-over and advisors are bracing to make sense of some of the most sweeping tax changes in decades.

For one, they saw homeowners in high-tax states rushing to prepay 2018 property tax bills before state and local tax deductions were capped at \$10,000. It is just one example of myriad of ways, often unexpected, that the new laws will change the status quo of tax planning. Whatever planners used to do routinely must be re-examined. Generalizations will prove to be dangerous.

The big Kahuna on the estate tax front is that exemptions have been doubled to about \$11.2 million per person ("about" because there is uncertainty surrounding the inflation adjustment and rounding until the IRS sets the figure). For a couple, it is \$22.4 million, at least until 2026, when it reverts to \$5 million per person, inflation adjusted.

Many tax experts, however, suspect that Republicans went too far pushing through tax legislation with so much tilt toward the wealthy that if the political dynamics shift sufficiently in 2020, the pendulum could swing in the opposite direction.

PLANNERS MUST BE THE CATALYST

It's important now to re-examine clients' existing estate planning: wills, revocable trusts, insurance plans, and more. While many clients will assume that "Gee, the exemption for a married couple is over \$22 million, I don't need to worry about estate planning," that would be dangerous.

The biggest challenge planners will face is getting clients to understand that a large exemption does not solve estate-planning issues. Clients might avoid discussing estate plans with their CPAs and attorneys. Foolishly, many will feel that they do not need to pay "hundreds of dollars per hour for advice I don't need because the exemptions are so high."



BLOMBERG NEWS

Planners will now need to re-examine clients' existing estate planning: wills, revocable trusts, insurance plans and more following approval of the tax overhaul.

It will be left to the advisor to educate clients about the need to revisit all of their existing planning, much of which may be wrong, depending on each client's circumstances.

REWORK OUTDATED WILLS

Planners know the drill but clients do not want to hear it. That 20-year-old, five-pager just won't suffice. "But if there is no tax issue why do I need a complicated will?"

Estate planning was never just about taxes. Clients love simple and with the estate tax irrelevant in their minds, they will want short, simple wills. But those wills do not include flexible trusts to protect surviving spouses and children from creditors and predators.

Wills do not include protections for later life and aging that a robust revocable trust does. Clients must know that real planning is needed.

BAD FORMULAS

One of the most dangerous problems with old wills and revocable trusts is the formula used to fund bequests

that have been twisted by the new high exemptions.

If a client signed a will or revocable trust in 2003 when the estate tax exemption was just \$1 million, the funding might have worked like this: "I give the maximum amount to a credit shelter trust that won't create an estate tax and the rest to my husband." The credit shelter trust might have been for the benefit of children from a prior marriage, or even children and a spouse.

If the estate was \$4 million, that meant \$3 million outright to the husband and the rest to share (or to others). Now, the entire estate will go to those others, or to a trust to be shared with others, and nothing outright to the spouse.

Even if the client's estate was \$10 million, the above pattern might have worked acceptably – the husband would have received nearly \$5 million outright – until the end of 2017, but in 2018 it could be disastrous. Many people have never updated their wills as the laws have changed. The huge increase in the exemption makes it critical to evaluate how the dollars flow.

THE MANY WHAT IFS

Bad formulas can appear in benefiting grandchildren as well. An old will written when the generation-skipping transfers tax exemption was \$1 million might have planned to set aside that amount for grandchildren and the balance for children.

"I bequeath the maximum amount that is not subject to generation-skipping transfer tax to the trust for my grandchildren. The remainder of my estate shall be divided equally among my children and distributed outright to them."

On a \$5 million estate with two children, that might have meant a trust of \$1 million for the grandchildren and \$2 million per child. Now the children get nothing.

Congress has tinkered endlessly with the estate tax. Addressing the many what ifs will make a client's documents more compli-

cated and costly, but anything less is risky.

Every irrevocable trust should be reviewed. Many old life insurance trusts were intended to pay an estate tax when the exemption was \$1 million. Does that plan still make sense? Clients should be guided to a more reasoned evaluation of what new purposes the old trust might now serve, or how the old plan can be modified.

REPURPOSE THE OLD TRUST

A physician client might have an old insurance trust for which the spouse and children are beneficiaries. Even if that policy will no longer be needed to pay an estate tax because of the high exemptions, what if the exemptions are reduced to the \$2.5 million, 2009 level proposed by the Obama administration? Unlikely, but possible.

What if the insurance policy is a good one and provides a great asset protection tool? Even if the estate tax is no longer relevant, the plan might work for other purposes.

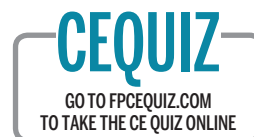
It is usually surprising how little clients remember about what old trusts provide. More than 20 states have laws that permit merging an old trust into a new trust (called decanting), which can facilitate updating administrative and distribution provisions to help repurpose the old trust.

POWERS OF ATTORNEY

Planners should review durable powers of attorney, as well. Many have provisions giving agents the right to make gifts. Are those relevant under current law or dangerous spigots for elder financial abuse? Many wealthy clients who should take advantage of the new high exemptions before they sunset or are legislatively changed will be uncomfortable doing so.

For them, perhaps a backstop is to recommend they have their estate-planning attorney update their powers to include a broad gift provision. That way, if they become incapacitated before the law changes unfavorably, the agent can use some of the new exemptions before they disappear. **FP**

It will be left to the planner to educate clients about the need to revisit all of their existing planning, much of which may be wrong.



Martin M. Shenkman, CPA, PFS, JD, is a *Financial Planning* contributing writer and an estate planner in Fort Lee, New Jersey. He is the founder of Shenkman Law. Follow him on Twitter at @martinshenkman.

Break Aw

Advisors such as **Greg Hersch** have long found professional fulfillment by leaving wirehouses to start their own firms. But with the Broker Protocol collapsing, will they find that path cut off?

BY ANDREW WELSCH

ay



After more than 15 years working at big brokerage firms, advisor Jim Denholm decided he'd had enough.

Denholm was concerned about what he saw as overemphasis on cross selling, and he wanted to have better technology when servicing clients. So last June, the former Wells Fargo advisor, who oversaw about \$200 million in client assets, left to form his own RIA, IronBridge Private Wealth, in Austin, Texas.

He spent his first day calling clients until 8 p.m., reaching all of them within the first two days.

"It was like the gun at the starting line had fired, and I was the first step into a 100-mile run," Denholm says. "That's how I feel. This is a long-term game that we are playing."

But the rules of the game are changing. For over a decade, wirehouse advisors have jumped from large brokerages to smaller independent firms. Clients have often followed suit. In 2017 alone, employee advisors managing nearly \$40 billion moved to RIAs or IBDs, according to an analysis of hiring announcements by *Financial Planning*.

All this movement was made possible in part by the Broker Protocol, a 2004 accord that permits advisors to take basic client contact information with them when switching firms.

THE FUTURE OF THE BREAKAWAY ADVISOR MOVEMENT MAY COME DOWN TO A TUG OF WAR BETWEEN A DESIRE FOR GREATER INDEPENDENCE AND THE FEAR OF BECOMING A LEGAL TARGET.

When Denholm wanted to explain to his clients why they would be better-served by his new RIA, it helped, of course, to have a list of their phone numbers and email addresses.

But Morgan Stanley and UBS' recent departure from the Broker Protocol has other firms also eyeing the exit, casting a shadow over the future of the industrywide pact. Could the protocol's demise cut off the flow of talent and assets from the wirehouse to independent channel? "It's clearly an impediment," says Rob Mooney, CEO of Snowden Lane Partners and a former Merrill Lynch executive.

The future of the breakaway advisor movement may come down to a tug of war between a desire for greater independence and the fear of becom-



Jim Denholm took clients' phone numbers and email addresses when he left Wells Fargo to form his own RIA in Austin, Texas. Now that wirehouses are leaving the Broker Protocol, advisors from those firms might find themselves in court if they try to contact clients at their former firm.

ing a legal target.

"We'll see what happens with how the protocol plays out," says Greg Hersch, a former UBS broker who opened his own RIA, Florence Capital

Advisors of New York, in 2015.

"But I think it stands to reason that if the large wirehouses are exiting it, then they will be more aggressive in defending their client lists."

Ex-employers could file lawsuits to block departing advisors from contacting clients. Such litigation was common in the pre-protocol world. And 2018 will test just how big a roadblock non-protocol firms can put in front of potential breakaway brokers.

"In effect, UBS and Morgan Stanley are stepping up their focus on financial advisor retention while simultaneously adopting a more protective posture," the Evercore analysts John Pancari, Samuel Ross and Rahul Patil wrote in a November research report. "Consistent with these actions, such

firms could also step up enforcement of non-solicitation agreements, thereby preventing brokers that have changed firms from contacting clients from the prior firm."

Between them, Morgan Stanley and UBS have more than 22,000 advisors managing about \$3 trillion in client assets. This gives their protocol decision enormous weight within the industry. Citigroup, which has about 1,000 advisors, said it too would exit the protocol early this year.

For its part, Morgan Stanley "will continue to expect departing advisors to honor their non-solicitation obligation after we exit the protocol,"

Consistency can pay dividends.

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With sales charge				
Class A (5.75% max. sales charge)	13.51	8.83	13.20	7.77

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a spokeswoman says.

In December, the firm followed through on that promise, filing a lawsuit against John Fitzgerald less than three days after the advisor, who is based in Vineland, New Jersey, left to form a new practice with the independent broker-dealer Commonwealth Financial Network.

The firm argued that Fitzgerald had signed a one-year non-solicitation agreement and that Morgan Stanley's resources and training were material factors in his ability to attract clients.

"His express obligations notwithstanding, Fitzgerald was contacting Morgan Stanley's customers by both telephone and email within an hour or so of his resignation," according to the firm's lawsuit.

A judge granted the firm a temporary restraining order, but with the caveat that Fitzgerald could reply to clients if they contact him.

Fitzgerald and his attorney did not respond to requests for comment.

WILL INDIVIDUALS HESITATE?

Though the merits of the case are distinct (Commonwealth is not a protocol member, for instance), it could

yet prove to be a harbinger of things to come.

"That asymmetry is what the wire-



Greg Hersch says building his own firm wasn't easy, but it was worth the effort. "I've never been more satisfied in my career," he says.

houses are counting on," says Elliot Weissbluth, CEO of HighTower Advisors, which has helped a number of large wirehouse teams go independent. "I think they are assuming that an individual will not want to face off against them."

But the wirehouses that count on

that strategy may find themselves mistaken, Weissbluth says: Individuals take on big institutions all the time.

DAVID VERSUS GOLIATH

Even when protocol protections are in place, there's a frenzied race that occurs whenever an advisor leaves a firm: Who will be the first to reach out to the clients?

In 2016, it took only 45 minutes after Sarah Keys' resignation before her ex-employer, Merrill Lynch, started sending emails to her clients. Keys and her three partners left the wirehouse to launch Cardan Capital Partners in Denver, and today their team oversees approximately \$700 million.

Take that horse race and, now with the non-protocol firms, add the prospect of a David-versus-Goliath court battle to the mix. Will the risk of a legal battle deter some wirehouse advisors from ever leaving?

It could, but that risk may also spur some advisors to seek allies, says Phil Shaffer, a former Morgan Stanley managing director who opened an independent firm, Halite Partners, last June.

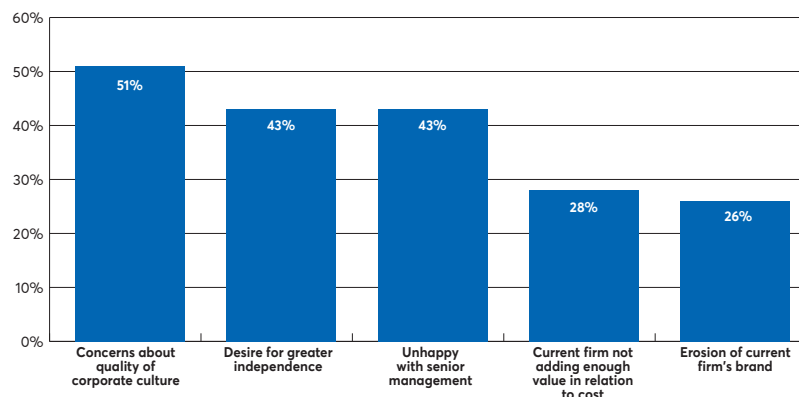
"The bigger teams might look at a two-step process," he says. "They might look for firms that have capital, that can help them in a legal battle, and then some years later, they'll take the next step and go fully independent."

Meanwhile, smaller teams with less than \$200 million in AUM could be driven to join existing RIAs in order to mitigate litigation risk, according to Shirl Penney, CEO of Dynasty Financial Partners. "You may see more sub-acquisitions or tuck-ins. Those firms are well funded and can support a move," he says.

Shaffer, however, adds an important wrinkle: By exiting the Broker Protocol, UBS and Morgan Stanley have diminished the value of their

Top 5 Reasons Advisors Make a Career Change

The major factors cited by brokers who changed firms in the past three years.



Source: Cerulli Associates' report U.S. Broker-Dealer Marketplace, 2017

advisors' practices because potential legal expenses will have to be baked into the cost of making a career change. In other words, recruiting deals offered by hiring firms could be smaller going forward.

It may also be necessary to more closely scrutinize an advisor's client list. "On any transition, people will have to get granular," says Snowden Lane's Mooney. After a close reading of any non-compete or non-solicitation language, then "it's more of a question of client size than book size. Is it 50 relationships? Or 100? How are you in contact with those clients?"

There's also unanswered questions as to how much favor the courts will show the firm.

Can an advisor who joined Morgan Stanley under the protocol take that same client list with him when leaving the firm now?

BEING THE GUINEA PIG

Industry insiders say advisors considering a career change are waiting to see who goes first and tests the legal waters. But which advisor wants to be that guinea pig?

Yet, even if all the big bank-owned brokerages quit the protocol, the reasons advisors have been leaving for smaller independent firms have not changed. Keys and her partners, for one, would probably have been underterred by a lack of protocol.

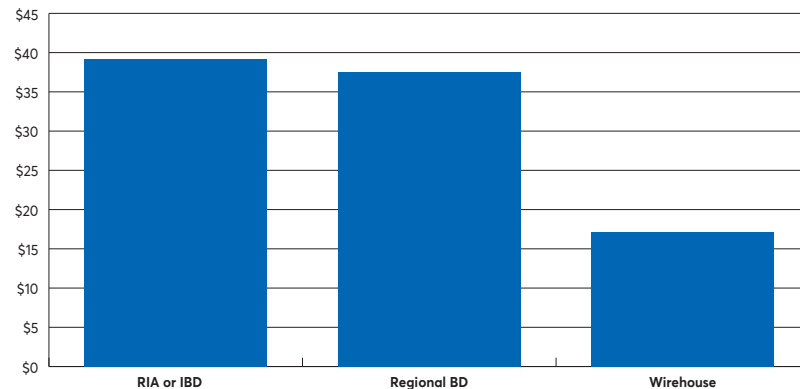
"I imagine we still would have done it," says one of Keys' partners, Ross Fox. "The people we talked to before we left all said that they wish they had done it sooner."

Hersch, the former UBS advisor, says building his own firm has been among the hardest things he's ever done – and he would do it again.

"I can say life might have been a little easier at a bank, but I've never been

A Flow of Talent – and Assets

Reported AUM of new advisor hires in 2017 by firm type, in billions.



Sources: Company announcements, *Financial Planning* analysis

more satisfied in my career than I am now," he says.

Concerns about corporate culture and a desire for greater freedom are among the top motivations advisors cite when making career changes, according to Cerulli Associates.

Becoming a non-protocol firm does nothing to mitigate discontent among the rank-and-file, industry insiders say.

"I think the banking culture is very different than the independent, boutique cultures," Mooney says. "It's inherently more bureaucratic. It's more process-driven and less people-centric."

In addition, the world advisors operate in today is very different than that of 2004, when UBS, Merrill Lynch and Smith Barney were the original signatories of the protocol. There are certain tactical advantages advisors have that they did not before.

"Broker Protocol was a system designed before social media, when mailing a letter or making a phone call was the only way to make contact with a client," Denholm notes.

Good advisors, he adds, are entre-

preneurial by nature. They'll find a way to overcome hurdles, including the lack of protocol protections.

Jim Gold, a former manager at Morgan Stanley and current CEO of the independent firm Steward Partners, agrees. "Facebook, Google, Twitter – all are a much bigger presence today," he says. "And even finding a phone number is easier."

'A RAGING RIVER'

Steward Partners, which is affiliated with Raymond James, has been an active recruiter of wirehouse talent. Since its founding in 2013, the independent firm has recruited more than 70 advisors managing about \$8 billion in client assets, according to the firm.

Gold doubts the exodus will suddenly end. He expects advisors to continue to find ways to move even if the protocol collapses.

The outflow of wirehouse advisors to independent RIA firms has "gone from a trickle, to a stream, to a raging river," Gold says. "You can't shut that off." It may be possible to dam the river, he adds. But, over time, water flows downhill. **FP**

Andrew Welsch is senior editor of *Financial Planning* and *On Wall Street*. Follow him on Twitter at @AndrewWelsch.

What's Next for the Broker Protocol?

Answers to top questions and concerns about the future of an industry accord that governs brokers when they switch firms.

By Andrew Welsh

With Morgan Stanley and UBS out of the Broker Protocol, questions are swirling around the future of the accord and its impact on recruiting. Are advisor moves finished? Will breakaways be snuffed out? Should FINRA get involved? *Financial Planning* reached out to top industry insiders and experts to find out what's at stake for advisors.

WHAT IS THE BROKER PROTOCOL?

It's an industry trade agreement created in 2004 by Merrill Lynch, Smith Barney and UBS that permits brokers to take basic client contact information with them when they switch firms.

The protocol reduced litigation between firms, which used to sue each other to block brokers from taking clients (and their assets) when switching employers.

Approximately 1,700 firms have become signatories. SIFMA, the industry trade group, used to maintain a list of protocol firms, but it transferred responsibilities for this to the law firm Bressler, Amery & Ross in 2015. Bressler sends out a weekly update on who has joined and exited the accord.

Morgan Stanley announced its intention to leave the protocol in late October, and UBS followed three weeks later. Both have drastically cut recruiting efforts recently.

IS THE PROTOCOL KAPUT?

This question leaves industry observers divided. One camp says the agreement can't survive without the support of the big four wirehouses, which collectively have more than 50,000 advisors (UBS and Morgan Stanley represent about 22,000 brokers). Stifel CEO Ron Kruszewski predicted that the accord would unravel in the wake of Morgan Stanley's exit.

But a second school of thought suggests that some firms, particularly the growing regional brokerages, will stick with the protocol in order to differentiate themselves from their wirehouse competitors.

"I think that as far as rival firms are concerned, they're pretty excited to use this as a recruiting opportunity,"

says Mark Elzweig, an executive recruiter whose firm specializes in advisors.

Protocol firms could tout their culture and respect for advisor choice when attempting to lure talent away from rival non-protocol firms, he says.

Raymond James, for instance, came out in support of the accord, citing advisor and client choice.

In addition, firms that choose to stay in the protocol will not have to worry about non-protocol firms poaching their talent because advisors will be reluctant to join a firm that won't let them amicably leave at a later date, insiders say.

"I think advisors want to know if they move to a firm that they are not chained to it for life, says attorney Nancy Hendrickson, a securities litigation partner at the Chicago law firm Kaufman Dolowich Voluck. "They want to know that should they later choose to leave a firm, they can do so amicably."

COULD THE BREAKAWAY MOVEMENT SUFFER?

For years, there's been a steady departure of top wirehouse advisors to start their own RIAs, often with the help of such firms as Dynasty Financial Partners and HighTower Advisors, which assist breakaways.

"When advisors circulated primarily among the wirehouses, it was easier to be part of the protocol, because what you lost, you also got back," says Rob Mooney, a former Merrill Lynch executive who is now CEO of Snowden Lane Partners.

Wirehouses are leaving the protocol primarily because of the growth of the breakaway movement, Mooney says. "It's a validation of the fact that the best advisors are seeking independence," he says.

Leaving the protocol may help a firm to discourage brokers from going independent. But being a non-protocol firm doesn't change the reasons that breakaway brokers want to leave in the first place. In other words, it's all stick and no carrot.

"The folks who were going independent have a strong independent streak, a strong entrepreneurial spirit," Mooney says. Leaving the protocol "will make moves

more difficult, but it won't completely stem it. Water finds its own equilibrium."

Snowden Lane, which has recruited several wirehouse teams, is not planning to leave the protocol, Mooney adds.

WHAT ARE NEGATIVE EFFECTS FOR ADVISORS?

Legal costs associated with making a career change will probably rise and the size of recruiting bonuses may shrink, experts say.

"When [recruiting firms] think about the type of deal they would need to hire advisor talent, then they need to factor in the legal cost," says Phil Shaffer, a former managing director at Morgan Stanley who founded Halite Partners in 2017.

"The acquiring firm will reduce some of the risk by saying, 'We'll pay you as you bring those assets over,' versus 'We'll pay you X upfront,'" he says.

Even if a recruiting deal offered by a non-protocol firm is enticing, advisors may want to think twice.

"I think fit and money are much bigger issues for the advisor than whether the firm is in the protocol. But if you were comparing two firms that are basically the same and only one was a protocol firm, then I'd recommend going to the protocol firm because you can take your clients with you, should you leave at a later date," says Ross Intelisano, a founding partner at the law firm Rich, Intelisano & Katz. "No one knows how these firms will use their newfound firepower."

Advisors are also advised to make sure that their exit from a non-protocol firm is conducted in a professional manner.

In the past, when firms have sued departing advisors for breaching the Broker Protocol's rules, they've subpoenaed communications. A 2017 legal battle pitting a breakaway RIA in Connecticut against UBS resulted in dozens of text and email messages between advisors and clients being made public.

HOW ELSE WILL IT CHANGE RECRUITING?

For advisory firms that have left or will leave the protocol, insiders predict hiring efforts will suffer because advisors will not want to join a non-protocol firm for fear they could never leave.

Shirl Penney, CEO of Dynasty Financial Partners, says: "One of the nuances that people may be missing is that when someone exits the protocol, it does two things. First, it makes it more costly for someone to make a move. But when a firm leaves the protocol, it makes it harder for them to recruit advisors."

WHAT WILL REPLACE THE BROKER PROTOCOL?

It's not clear, but everyone interviewed for this article lamented that there might not be a client-friendly system to replace it.

"I scratch my head on why we don't have something more client-centric here," Shaffer says. He adds that Halite Partners will remain in the protocol.

Meanwhile, calls are mounting for regulators to get involved. "I don't think the protocol was enacted with the clients foremost in mind, but it probably served them more than anyone when compared to the previous regime," says Hendrickson, the securities litigation specialist. If the protocol collapses, it will leave a void along with many unanswered questions. "Someone should step in, and the logical actor would be the SEC or FINRA," she says.

In a worst-case scenario, clients could be left in the lurch as advisors and firms file temporary restraining orders against one another in court, arguing over whom the client belongs to.

"We ought not to be encumbering clients in the midst of litigation by determining client names are trade secrets," Mooney says.

But whether regulators would get involved is unknown. At the moment, the focus in Washington is on deregulation – not the opposite.

FP



If the protocol collapses, "someone should step in," says Nancy Hendrickson, a securities litigation specialist. FINRA and the SEC are candidates.

PRACTICE

ALSO IN PRACTICE: P. 36: Meeting of the Minds | P. 38: Lightning Round with Advisor Group CEO Jamie Price

Hit ‘Reset’ on Firm Culture

Advisors need to examine whether they’re truly creating a respectful work environment as sexual harassment allegations overwhelm other industries.

BY CAROLYN McCLANAHAN

THE WOUNDS ARE OPEN, AND IT'S TIME TO START down the long road to healing. Before we can do that, however, we have to wonder why we haven't seen more reports about sexual harassment out of the wealth management industry. In part, I believe it's because our male-heavy finance culture went through a slew of cases in the 1990s, including the infamous “Boom-Boom room” case at Smith Barney.

These cases heightened awareness of the subject. Yet the recent departure of two long-term, male, high-ranking employees at Fidelity Investments offers evidence that we still have a long way to go. Thankfully, Fidelity's leadership handled this head-on and realized that training around these issues needs to be ongoing.

Is this form of abuse a problem in smaller advisory firms? Of course it is, but there are differences between large and small firms.

First, employees at smaller firms are less likely to have support from large human resources departments, and it's doubtful their allegations will make headlines. As a result, they may be more hesitant to come forward with harassment claims.

Second, the smaller the firm, the more sway the owner of that firm has in setting the culture. Most firms are run by men, and if they are obtuse about sexual matters, there is probably an issue. I heard recently from a woman who was invited to join a 100% male firm because they wanted to be more inclusive. She learned quickly just how insensitive the men in the firm were about the issue of sexual harassment.

When placed in a sexually uncomfortable situation, women have historically used a variety of techniques to defuse the situation – laughing it off, avoiding the subject or being icy. Sometimes we just gave in. Our jobs are important to us, and we often can't afford to lose them.

Accepting the status quo was sometimes the only choice. Being in the one-down situation made it tough for women to fight back as a group. What we lack in the workplace is the



After reports of sexual harassment at Fidelity Investments, CEO Abigail Johnson moved her office closer to fund managers.

setting of a tone that makes harassment less likely. Sadly, many men don't even realize it's happening.

This has to change.

BEYOND PUNISHMENT

Is penalizing the perpetrators of sexual harassment the way forward? I'm afraid if this is the only action taken, we all will lose. While abusers must be held accountable, will punishment after the fact change the underlying culture that allowed their bad behavior in the first place?

There are two broad actions that would make lasting positive change for small firms as well as large ones. Ten-person independent firms have as much responsibility to support and protect workers as their much larger peers.

First, all financial services firms should immediately fill their boards and executive-level positions with at least half women. Boards need to reflect the diversity of the broader population. That would mean we need to hire more women and minorities. The CFP Board has several initiatives in place to make this happen.

Fresh, diverse leadership can more easily reset the tone of organizations.

Second, financial firms need to develop and codify positive cultures going forward. Requirements for open communication, intolerance of bad behavior and how to deal with sexuality in the workplace should be addressed in corporate engagement standards.

Employees should be assigned as culture keepers to foster a great working environment, and they must be given the power to address those people who are not following the culture.

Of course, we are all sexual beings. Sexual behavior outside of what society views as right is rarely discussed in a healthy manner.

People harboring sexual desires outside the norm frequently develop unhealthy mechanisms to cope with their feelings. Porn addiction and the hiring of sex workers are behaviors we may see in people who otherwise lead what appear to be exemplary lives.

People in power have the ability to fulfill sexual needs by taking advantage of those they oversee in the workplace. It's important to create a zero-tolerance sexual harassment policy, provide regular opportunities for open and direct communication so all employees can discuss uncomfortable situations, and make ample use of therapists trained in workplace communication to reduce the chance that people in power will act on these impulses. Of course, the people in power have to set these policies in the first place.

In our firm, we discuss openly uncom-

fortable issues integral to our personal lives and the wider world. Our corporate engagement standards are reviewed and updated at least yearly, or whenever we hire a new employee. We even have a therapist on retainer to work with us as a group and individually help with communication and culture issues as they arise. This fosters an envi-

ronment of safety, trust and encouragement to address hard issues as they come up.

What about normal sexual attraction? With a significant amount of our time spent with co-workers, how can it not

happen? Communication and sane policies about how to deal with attraction in the workplace are a must.

Fostering a safe environment for conversation and support is critical. I suggest making "Fierce Conversations" by Susan Scott

required reading, or offering sensitivity training (I recommend Fierce Inc. training). These actions can build the cornerstone for healthy workplace communication. Employees may also develop the skills they need to handle healthy workplace romance, as well as harassment and abuse.

A workplace is like a family, and all families have some dysfunction. By addressing our dysfunctions openly through empathy, communica-

tion and a desire to create a great life for all involved, we can create healthier and happier families.

Add in a change in the balance of corporate power, and we will be well on our way to healing and creating a better future for all of us.

FP

Is penalizing perpetrators of sexual harassment the way forward? If this is the only action taken, we all may lose.

For more insights on how to stamp out sexual harassment in wealth management, please see p. 18

NEWLY REVISED AND UPDATED
National Bestseller

**FIERCE
CONVERSATIONS**

Achieving Success
at Work & in Life,
One Conversation
at a Time

SUSAN SCOTT
Foreword by KEN BLANCHARD, PhD

Carolyn McClanahan, a CFP and M.D., is a *Financial Planning* contributing writer and director of financial planning at Life Planning Partners in Jacksonville, Florida. Follow her on Twitter at @CarolynMcC.

Meeting of the Minds

Assembling an advisory board of your most candid clients can yield honest feedback and advice on nearly everything about your firm.

BY INGRID CASE

WHAT WOULD HAPPEN IF YOU GATHERED YOUR most forthright clients and asked them for their blatant honesty? Could such an advisory board help you identify possible problems, take on new challenges and build a more successful business?

It's worked out that way for Amy Irvine, owner of Irvine Wealth Planning Strategies in Corning, New York. When Irvine's current firm was just a twinkle in her eye, she assembled a group of clients into a six-person advisory board.

Irvine, who was then in a partnership, specifically wanted the board's opinions about the possibility of opening a solo firm. The group met three times in the first year, first assembling in a rented conference room across the street from Irvine's office and then in a local restaurant.

"Their biggest concern was with all the services I was considering adding," Irvine says. "They wanted to know where the line was for me. Would I either add staff or stop accepting new clients? How would I incorporate new services without other services suffering?"

Once Irvine had answered those questions to the board's satisfaction and decided to open her own firm, she talked with her advisors about how she should tell clients about the change (individual telephone calls, the board said), and got advice about questions clients might ask: "What's my backup if something happens to you? How does this affect me? Why are you changing?"

Hearing the questions from her advisors helped her

address those subjects in a confident way before other clients even asked, Irvine says.

After the transition, Irvine and her board have talked about other issues, like how much she should charge and through what structure. "They really wanted me to be able to do tax returns for my clients," Irvine says. So, she became an enrolled agent and started doing client tax returns.



"I absolutely wanted gender and occupational diversity on my board," says Amy Irvine of Irvine Wealth Planning Strategies.

JUST LISTEN

It's clear that when her board talks, Irvine listens. The same is true of Kashif Ahmed, president of American Private Wealth in Woburn, Massachusetts, who has maintained a board of eight to 10 client advisors since 2012.

A proud immigrant, Ahmed typically wears a suit and tie. "One client said that she feels a little intimidated because I am so well dressed," he says. "I said, 'That's it, no more ties for client meetings.'"

Another client had feedback about Ahmed's website. Ahmed spent \$5,000 to make the changes the board recommended. His board suggested client reviews that are lighter on the technical investment details, and Ahmed adjusted accordingly. The only

advisory board recommendation he rejected was the suggestion that he communicate with clients by text message rather than by email. SEC rules wouldn't allow it at the time.

Ahmed is deliberately quiet during much of the meetings, preferring to let board members talk. "This shouldn't be a time to show off or a way to get referrals," he says.

Irvine chooses her board members for their ability to be

constructively honest. Ahmed looks for clients who sincerely care about him and his business — a group that includes both large and small clients.

BOARD DIVERSITY

Invitations to join the board are best done via personal phone calls or in-person conversations, Irvine and Ahmed both say.

Meanwhile, some advisors may also want

often should it meet? Eight clients serve currently on Ahmed's board. As at Irvine's firm, the group gathers regularly to eat and talk, once a year for Ahmed and twice a year for Irvine, usually at a local restaurant. Meetings last for an hour or more, depending on what the group plans to discuss.

FREE-FLOWING CONVERSATIONS

Both Irvine and Ahmed rotate board mem-

Consider gender, age, racial and occupational diversity to ensure that advisory board voices come from different perspectives.



Client advisory board meetings “shouldn't be a time to show off or a way to get referrals,” says Kashif Ahmed, president of American Private Wealth in Woburn, Massachusetts. Ahmed is deliberately quiet during much of the meetings, preferring to let board members talk.

to consider the diversity of their boards. Considerations for gender, age, racial and occupational diversity can ensure the voices at the table come from different perspectives.

“I absolutely wanted gender and occupational diversity on my board,” Irvine says. “Women have different concerns than men, and each gender and occupation generally makes decisions differently.”

Since, in most cases, clients will be donating their time to serve on the board, it's important to thank them with food and drinks during meetings and handwritten thank-you notes afterward.

How big should the board be? And how

members out on a staggered basis, so that clients might serve for two or three years, but the entire board doesn't turn over at the end of each period.

In advance of each meeting, members should get an agenda to help prepare them for the top discussion questions, but during the meeting, the conversation can often flow freely around open-ended questions. “I do most of the listening and they do most of the talking,” Ahmed says.

Irvine and Ahmed both plan to keep their boards for as long as possible.

“This has been very rewarding for me,” Ahmed says. **FP**

Ingrid Case, a *Financial Planning* contributing writer in Minneapolis, is a former senior editor of *Bloomberg Markets* magazine. Follow her on Twitter at @Caselnggrid.

Lightning Round With Jamie Price

It's been a busy first year for Advisor Group's new chief executive. He responds candidly to rapid-fire questions.

BY CHELSEA EMERY

BUSY DOESN'T QUITE SUM UP JAMIE PRICE'S FIRST year as CEO of Advisor Group. Among his many challenges, the firm, which split off from AIG in 2016, had the herculean task of readying its network of independent broker-dealers for the first phase of the Department of Labor's fiduciary rule. Advisor Group also introduced flat fees for its advisory and brokerage platforms and launched a low-minimum advisory account for clients called Genesis Direct.

Coming months will not bring respite. Executives in all industries are scrutinizing company culture as employees speak out about sexual harassment. Robo advice is pressuring fees and margins, and bitcoin's rapid gain has many advisors seriously evaluating cybercurrencies.

Price's candid responses to a lightning round of questions follow. Answers have been condensed and edited.

Financial Planning: What's your take on cybercurrencies such as bitcoin?

Price: It's way early in the process but there will likely be a cryptocurrency capability, whether it's bitcoin or something else. The technology that it runs on – blockchain – presents lots of interesting opportunities across a wide spectrum of the financial services industry, beyond the actual currency itself.

On the investment side, we'll just say it looks kind of speculative to me. I think it's way early to be placing bets on what kind of cryptocurrency [will become commonly used], or whether bitcoin is the one. But I think everybody believes, and I do as well, that digital currency is going to have a place.

The technology it runs on holds more interesting possibilities for the financial services industry, to essentially dis-

aggregate value chains and repackage them up one at a time, in a more efficient way.

Financial Planning: Do you see more of a role for robo advice?

Price: Absolutely going to become mainstream. Advisors will be using it, and the largest use of robo technology over the next five years will be in the hands of mainstream advisors who work with investors.

We are building our own digital platform. It's one of our big strategic initiatives. We have a four-party agreement: Jemstep, Advisor Group, Envestnet and Pershing. We are fully integrating all of our account opening processes to go paperless from the start. Inside of that, there will be a robo platform that can be leveraged with various clients to the full or partial degree that you want to leverage it. It will be integrated right inside of our platform as a robo offering.

Financial Planning: How will revelations of sexual harassment in the workplace affect the planning industry?

Price: I think there will be a lot more training and education. The first questions that have to be asked are: How diverse is your company – both within the top leadership and throughout? And how do you actually get open

dialogue happening inside of a company, in a trusting way, where you as a company can decide the culture that all employees want to live by and hold their standard up to?

We certainly are doing that through our cultural values, and through some of the training and education we plan to do this year. This also includes possibly doing something for advisors. They could leverage the capabilities we have to help their own training and education efforts throughout



"Digital currency is going to have a place," says Advisor Group CEO Jamie Price.

their own independent organizations.

Financial Planning: What can be done to make succession planning a higher priority?

Price: It's a question of risk management. If you were working in a big company and didn't have one in place, you'd be doing a disservice to your clients and the viability of your practice. I think everybody should have a succession plan. The question is, how robust does it need to be? If you're within 10 years [of retiring], you should have a plan in place. Your clients deserve it.

Mysuccessionplan.com just launched. We had a subscription rate goal and we've exceeded that. We believe there is a big opportunity to help advisors who – over the next year – either want to slow down and/or want to have a succession plan. This ultimately could end up in a sale of the business, but may just be a succession before a sale.

We want to be the firm that is viewed as providing capabilities for them to do that seamlessly, and quite frankly, to be able to do it in a way that gets at the soft issues first.

This is a legacy question, first and foremost. How do they find like-minded individuals who will continue to handle the clients that are near and dear to their hearts? Who live in the communities they work in? Who are philosophically aligned – culturally and investment philosophy-wise – how they want to handle clients? And finding that match first is the key before money or anything else comes into play.

So our platform is built around anonymity, and being able to go in and find a cultural fit first, and match buyers and sellers in a more elegant way. And then of course we have our whole succession planning department that helps facilitate that in a hard way, meaning contracting, build philosophy, how you value businesses, etc.

Financial Planning: How do you articulate your strategy on fees?

Price: For us, it was simplifying fees. In other words, not having multiple types of fees but a flat fee where possible.

When we went to our singular ticket charges for advisors last year – \$9 on advi-

sory, \$15 on brokerage – it was to do away with all those little nickel-and-dime fees: the conference fee, the mail fee, the statement fee. And have just a flat, one-time fee, which we've done.

Secondly, it's transparency. More and more advisors are going to show the full transparency of costs, including what the advisor themselves is tacking on for their advice and what a client is truly paying all-in, no matter what the product is or what the choices of product are.

Transparency leads to a level of trust and honesty, and it doesn't preclude you from picking the right solution. Even if it costs more, if it's the right solution, it should perform as it is intended to do.

Transparency is a way for advisors to bring one more piece of value to a complicated issue with clients, to be the light that shines on transparency and openness, for clients to make better informed decisions.

Financial Planning: What is your fiduciary outlook?

Price: Obviously, we are in the impartial conduct standards now, which means we are in a fiduciary era, and have to operate as one.

Those standards are pretty clear, from June 9. The rest of the bill got pushed out to June 2019.

Our view is that the SEC is actively looking to pick up the mantle here and either work with the DoL, or create a fiduciary standard themselves that we hope will cross both qualified and nonqualified business.

Financial Planning: What else is top of mind for you right now?

Price: This year, the stuff we're going to be talking to our advisors about is, what will the next five years look like?

We believe fee compression is going to continue to happen, as you get more transparent, and new entrants like robo will allow clients to have scalable offerings for a price. I think advisors will be still hugely valuable, but they're going to have to reorient their value proposition to be more all-encompassing. And they're going to have to manage more assets in order to continue to grow. **FP**

“If you're within 10 years [of retiring], you should have a plan in place. Your clients deserve it,” says Advisor Group CEO Jamie Price.

Bitcoin's Millennial Appeal

Advisors should understand how the cryptocurrency attracts a generation that believes in the power of networks.

BY JAMES THORNE

IT WASN'T BECAUSE I THOUGHT IT WAS GOLD. AND I doubted it could kill the dollar. So why did I buy bitcoin? The answer has more to do with the community than the currency, and may contain lessons for advisors working with millennial clients.

My introduction to bitcoin was a bit unusual. When I was reading "Digital Gold," a book about bitcoin's origins by Nathaniel Popper, I came upon the name of someone who had attended my high school: Erik Voorhees.

The founder of digital currency exchange ShapeShift, Voorhees was also one of the early advocates of bitcoin. I called him to see what I could learn.

Voorhees talked about the role of trust in fiat currencies, and how the purpose of blockchain was to replace trust networks. Much of this went over my head. But his enthusiasm stuck with me. I watched news reports about how the community navigated crises and weathered hacks. Each time the community found a path forward, the currency's value rose.

If you advise millennial clients, it's worth keeping in mind that we came of age in an era of ideas that live or die on networks. Companies such as Facebook and Netflix have adopted user growth, rather than just profit, as a key metric of success. From that vantage point, bitcoin's vibrant and growing community is hugely valuable.

I bought a small amount of bitcoin over the summer with the thought that, if enough talented and dedicated people want an idea to become a reality, it's probably inevitable that it will.

I wasn't alone. Leading cryptocurrency exchange Coinbase now has over 10 million users. I'm also right in the crypto sweet spot, as 43% of millennial men would prefer to own \$1,000 worth of bitcoin than government bonds, according to a 2017 survey by Harris Poll for Blockchain Capital.

I didn't jump for joy when my investment doubled — then tripled. Like others, I found the price shocks frighten-



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ing. What financial education I had centered on modern portfolio theory, and nothing about bitcoin seemed to fit into that model.

Still, I couldn't ignore the optimism the crypto world had for this coin. As a 20-something who can only view my retirement through a telescope, I can afford to be patient. For now, I've resolved to leave my bitcoin stake alone for a decade. I don't see my small stake in cryptocurrencies as an investment. Maybe it's a gamble. But I prefer to think of it as something else: a few coins thrown into a fountain that might someday bring good luck.

Advisors may balk at clients who want to own bitcoin. Rather than fight them right away, advisors should listen to their clients' reasons for wanting to own it. Do they want to ride the wave, or are they convinced it has a real future? Their answer could provide insight into their mindset. After engaging in this discussion, you might even decide that, if they invest in a small crypto stake, it may scratch their itch without endangering their portfolio.

FP

James Thorne is a *Financial Planning* contributing writer. Follow him on Twitter at @jamescthorne.

Could Robos Turn ‘Evil’?

Scholar warns that digital advice could theoretically be vulnerable to bait-and-switch and choice manipulation schemes.

BY SEAN ALLOCCA

ROBO ADVISORS ARE PITCHED AS CONFLICT-FREE automated advisors. But can they be designed to work against client interests? Some scholars say questions need to be asked about digital advice models now being developed.

“Regulators need to learn more about how these things are actually working,” says Tom Baker, a professor at the University of Pennsylvania Law School and co-author of a recent paper on the future of robo regulations.

With the digital investment space projected to exceed \$1 trillion in client assets under management by 2020, watchdogs could have a lot of catching up to do if they don’t act fast, he warns. FINRA and the SEC have released recommendations and exam guidelines for robo advice use and application by RIAs. But Baker is worried that not enough inquiry has been made into the algorithms at the heart of robo platforms used to suggest investment products.

HUMAN ERROR AND ‘INCOMPETENCE’

These algorithms synthesize millions of data points – from broad market data to client risk tolerances – and suggest suitable products. But what if those equations are skewed to suggest one product over another?

“Regulators need to get involved and ask for clear explanations of exactly what algorithms are doing and why,” he says. “Then, test the algorithm – that’s not rocket science.”

Not only do algorithms have to treat all products equally, he says, they need to be technically sound as well. Because the equations are built by people, human error could be introduced at a fundamental level that could compromise the entire system. “The other issue is incompetence,” he says. “They might just be badly coded.”

One particularly troubling scenario is a bait-and-switch on a hybrid advice platform, Baker says. Investors may see one product available on the firm’s website and decide to



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Humans may inadvertently introduce errors into algorithms that could compromise an entire system.

learn more about it. But when they telephone their advisor, suddenly that product no longer exists. “The website could say one thing,” Baker says, “but the advisor could switch the product out for one with a higher fee.”

And while algorithms can theoretically skew product suggestions, the platform’s architecture itself can influence how clients choose the recommended products, he says.

“There’s been a lot of research by people in marketing and behavioral economics around ways that decisions can be structured for good or ill,” Baker says.

For example, changing the colors in which some products are displayed – or just manipulating the order in which they’re displayed – can have a serious impact on the client’s final decision. “Now, imagine that being done in an evil way,” he says, adding that a more lucrative product with higher fees could be displayed in green, while competitors’ products show up in orange.

Baker notes there is no evidence of manipulation. “There isn’t any indication that choice architecture is being used to mislead people,” he says, “but it sure could be.” **FP**

Sean Allocca is an associate editor of *Financial Planning*. Follow him on Twitter @sjallocca.

Why Clients Mistrust Advisors

Has success made you complacent? You may have picked up some bad habits over the years. Here's what to do about it.

BY ALLAN BOOMER

IN GENERAL, FINANCIAL PLANNERS DO NOT HAVE the best reputation. I should know – I've been working in the industry for the past 20 years.

I have been to cocktail parties where people walk away the moment they hear that I'm a financial advisor. But why? And what should we do about it?

About three years ago, I recruited an advisor who came from the entertainment industry. Not only was she from outside our sector, she's also a millennial.

Although it was my job to train her, I wound up learning a lot myself. She brought a fresh set of eyes to my business and our entire industry that I found both helpful and uncomfortable. In the end, her feedback on the things clients probably hate about us have helped improve my practice.

WHERE WE FALL SHORT

The first thing I learned is that we need to improve our communication skills. Many of us are not good listeners – present company included. At best, we are selective about what we hear. At worst, we miss key facts about our clients' personalities and family dynamics that may well leave them feeling misunderstood.

Next, we default to jargon and financial speak that we think makes us look smart, rather than taking the time to really explain concepts at a basic level that a client can grasp.

In addition, we are not good at answering questions. We spend a lot of time hedging our responses out of fear of being taken too literally.

Some of us think or act as though we are much more

intelligent than our clients. When they suggest things they want to do with their money, we often steer them away or dismiss their ideas as too risky. I have even seen advisors callously make fun of clients behind their backs.

We may know more about financial markets than they do, but many of our clients are successful in their own right. They excel in their careers, run businesses and have good ideas – if only we take the time to listen to them.

Advisors are not always open-minded about change. We invest in the same things we have always followed. We aren't always proactive about learning about recent innovations or about adapting to them.

How many times has your client asked about such things as cryptocurrency, blockchain, robo advisors, socially responsible investing, venture capital or marijuana? How often have we replied with one-liners like, "It's too risky," or "I don't understand it?"

Our industry is too homogenous. Think back to the last time you walked into a wholesaler luncheon – there was probably not much diversity in terms of age, gender and ethnicity. We all sound and look alike.

But we can learn something from people who look different from the prototypical advisor. Women, millennials and minorities are underserved by the wealth management industry when there is a dearth of advisors who fall into these categories.

Last, we don't present ourselves or our ideas very well. My new advisor's former industry is one where appearance and presentation are paramount. Most media and entertainment executives convey sophistication by wearing clothes



Allan Boomer confesses that, despite his 20 years of experience, a newly hired advisor from another industry helped him spot shortcomings at his own firm and the entire industry.

with a custom fit, and updating their wardrobes regularly. In terms of presentation materials, the entertainment industry is light-years ahead. Presentation books are visually and aesthetically pleasing. There is brand consistency and attention to detail on small things like fonts and colors, not just typos.

What's the solution?

Communication: Consider bringing someone else to client meetings to be a second set of ears – perhaps someone junior at your firm. Exchange notes with them afterward to analyze what was really said.

Write things down – especially specific phrases used by your client. What were they really saying? Or asking? Drop the finance-speak – remove all acronyms from your lexicon unless you define them.

Open-mindedness: The next time your client has an idea, research if it's feasible and investigate ways to implement it, instead of immediately dismissing it.

Assume the clients are going to implement the idea with or without your help. Think of ways to help protect them.

Diversity: Mentor someone whose background is different from yours. Bring on an intern this summer and teach him or her about more than cold calling and low-level administrative work. Hire a millennial and prepare yourself to be open to a two-way exchange of information.

Appearance: If you are still wearing a suit that is more than 10 years old, it may be time to upgrade your wardrobe by hiring a tailor or stylist. Also, hire a design company and

update your marketing materials and client review books.

In summary, many of us have been resting on our laurels. Frothy stock markets have made us too comfortable. Our jobs have been extremely easy in recent years.

News flash: Competition is coming. Whether it's robo advisors disrupting our industry and driving our profit margins lower, or millennials who aim to do business differently. We should all embrace the concept of continuous improvement.

If we want our clients to love us, we have to do more than just deliver returns. We have to listen better, present ourselves better, step outside of our comfort zones, and find better ways to connect with our clients.

If our clients feel unimportant and misunderstood, perhaps that robo advisor will seem like a more attractive option. **FP**

If you are still wearing a suit that is more than 10 years old, it may be time to upgrade your wardrobe by hiring a tailor or stylist.

Why Did the Advisor Lose Trust?

Vanguard asked almost 4,000 investors if they had lost trust in an advisor. For those whose trust had been compromised, here's what went wrong (multiple answers allowed).

	Percentage
Caused my portfolio to underperform	46%
Did not pay enough attention to me or my portfolio	44
Steered me toward poor investment choices given my risk tolerance and goals	43
Did not achieve what they set out to achieve for me	35
Did not make me feel that my business or portfolio was important	34
Lack of timely communication	34
Did not follow up or do what they said they would do	25
Condescending	22
Did not explain things to me in a way that I understood	21
Did not take my concerns or questions seriously	20
Did not understand me as an investor	19
Did not act morally	18
Did not respect my spouse as an equal partner	6
Took advantage or acted in own interest	5
Poor advice or investment decisions	4
Acted illegally	3
Unclear about fees (and other fee-related concerns)	2

Source: "Trust and Financial Advice," Vanguard Research, 2017

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4 Things to Know About Texting

Advisors needn't avoid it altogether, but there are some best practices to keep in mind — and some pitfalls to avoid.

BY PAUL HECHINGER

MANY ADVISORS ARE RELUCTANT TO USE TEXTING

to communicate with clients, but texting has become so ubiquitous that it simply isn't possible for advisors to ignore, and they shouldn't even try.

"Clients want it," says Sayer Martin, chief operating officer and co-chief technology officer at Orchestrate, based in West Des Moines, Iowa, which develops software for advisors. "And advisors are responding to what clients want."

Advisors shouldn't fear texting with clients. Instead they should embrace it, as it can be a valuable communications tool if used properly. But be aware of the pitfalls, as well as the right way to use texts. Here are four tips:

1. Be compliant. Martin thinks that advisors may be less hesitant about compliance issues after the Financial Industry Regulatory Authority clarified that it regards texting as an acceptable form of advisor-client communication, as long as business-related communications are secure and recorded.

Of course, just as with email or phone messages, advisors aren't going to make trades, move money or take significant actions based on texts alone.

2. Figure out how clients want to use texts. Clients are most likely to use texts with their advisors the way they use texts with anyone else: for logistics ("Running late — be there in 10"), reminders ("See you Tuesday") or checking in ("Did you see the email I sent?").

"It could take the place of an email or notifying clients that their account statement is ready," Martin says. "It's helpful for little things, like when a client doesn't want or need to get on the phone and have a longer conversation. If you're only seeking one or two data points, texting can be ideal."

And while there is a tendency to think that only younger clients use texts, Martin says that many older clients are just as interested in saving time.

Don't assume that your younger clients always prefer



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texting, says David Geibel, senior vice president at Univest Wealth Management in Souderton, Pennsylvania.

"My younger clients still want the phone call and the personal touch," he says. "After all, that's the reason they came to a full-service advisor in the first place."

3. Know the limitations of texting. It is important to understand that texts can't take the place of substantive conversations or face-to-face meetings, Geibel says.

"If you start relying on bursts of communication, as opposed to phone calls or client meetings, and you're trying to replace that with email, or God forbid, texting, it's a recipe for disaster," he says.

4. Manage expectations. The good news is that most clients instinctively understand when texting works best.

But, like most of us, they may be used to getting replies within minutes. Besides explaining to clients that replies may be slower during nonbusiness hours, advisors should make sure staff members get copies of texts to make response times faster.

FP

Paul Hechinger is a *Financial Planning* contributing writer in New York. Follow him on Twitter at @PaulHechinger.

PORTFOLIO

ALSO IN PORTFOLIO: P. 49: When Clients Misperceive Risk

Do-It-Yourself Pension Managing

There are ways a planner can confidently ensure a client will not run out of money. But some approaches have more drawbacks than others.

BY CRAIG L. ISRAELSEN

WILL I RUN OUT OF MONEY?

Every retiree is likely to ask this question at some point. Answering it is complicated but very important, especially as the traditional benchmark of retirement income, the defined-benefit pension, has largely disappeared.

Pensions typically offered retirees a fixed amount each month for the rest of their lives. Usually, the monthly income would never increase, but, even so, the certainty of getting a check was reassuring. The retiree often had no idea what rate of return the pension fund was earning – this was not their issue; it was the responsibility of the former employer.

Fast forward to today, and we live in a defined-contribution world where each person is essentially his or her own pension fund manager.

Is it possible to recreate the certainty of a pension in a 401(k) and IRA world? Yes, of course. But, there are trade-offs.

THE FIRST TRADE-OFF

In the table “The Path of Certainty,” I consider a \$500,000 retirement portfolio that’s invested in an account with a fixed annual return of 2% (in laddered CD’s, for example). If the retiree withdraws 5% of the starting balance, the fixed annual withdrawal is \$25,000. The retiree knows with certainty the annual return of the retirement portfolio (2%) and the amount that can be withdrawn annually (\$25,000). In this case, the portfolio will last 25 years before the bucket is basically empty. End of story.

If, however, the retiree withdraws only \$20,000 each year (4% of the beginning balance), the same retirement account will last 35 years. Finally, if he or she chooses a 3% withdrawal rate (a \$15,000 annual withdrawal), the portfolio will last for more than 40 years.

It’s important to note that the annual withdrawal in each scenario does not increase, meaning there is no inflation adjustment. If certainty is the goal, the retiree simply needs to lock in a 2% return and the portfolio slowly erodes right on schedule. The trade-off in this approach is that the portfolio



is completely liquidated in 35 years (assuming a 4% withdrawal rate). There is nothing left if the retiree happens to live longer than 35 years.

Hence the gravity of the question “will I run out of money?” The uncertainty grows if the retiree lives an unusually long life.

INTRODUCING VARIABILITY

One solution to this problem is to surrender at least part of the certainty. That can happen in two key ways: the annual withdrawal is variable or the return of the portfolio is variable. The table “Retirement Income Menu” explores this semicertainty, mapping out various portfolio outcomes.

This table is also based on a retirement portfolio that starts with a \$500,000 balance. The analysis assumes a maximum retirement period of 40 years. It also assumes that the retiree begins taking distributions from the portfolio at age 70½, in line with required minimum distributions for tax-deferred accounts.

The table is divided in half based on the performance of the retirement portfolio: a fixed return (in this case, 2%) and

The Path of Certainty

Guaranteed retirement income for 25, 35 or 40+ years with little or no money remaining. Fixed annual withdrawals from a \$500,000 retirement portfolio with a 2% fixed investment return.

an uncertain one (a retirement portfolio that has a variable return).

Assuming a fixed annual return of 2%, the retiree has three options. The first is to simply withdraw a set amount of money each year (Column A). In this analysis, the withdrawal is set at \$20,000. There is no variation in the annual withdrawal, meaning there are no cost-of-living-adjustments. In this scenario, the portfolio lasts 35 years, and the total amount withdrawn is \$700,000. If the retiree is still alive at this point, however, he or she has run out of money. That's a problem.

An alternative is to annually withdraw 4% of the portfolio's end-of-year value (Column B). This results in gradually diminishing withdrawals each year (\$18,593 on average over the first 10 years), but the trade-off is that the portfolio lasts for over 40 years. A simple solution to avoid outliving your retirement portfolio is to move from a fixed annual withdrawal to a percentage-of-ending-portfolio-balance annual withdrawal.

If the retirement account is governed by the third option, RMD rules, the only choice is whether the retiree invests the portfolio to provide certainty, like the 2% fixed annual return in this analysis, or to have variable returns. Surprisingly, if the retiree chooses a 2% fixed return

# of Years Retirement Portfolio Remained Solvent	End-of-Year Portfolio Balance with Fixed Annual Withdrawal of \$25,000 (5% of starting balance)	End-of-Year Portfolio Balance with Fixed Annual Withdrawal of \$20,000 (4% of starting balance)	End-of-Year Portfolio Balance with Fixed Annual Withdrawal of \$15,000 (3% of starting balance)
1	\$485,000	\$490,000	\$495,000
2	\$469,700	\$479,800	\$489,900
3	\$454,094	\$469,396	\$484,698
4	\$438,176	\$458,784	\$479,392
5	\$421,939	\$447,960	\$473,980
6	\$405,378	\$436,919	\$468,459
7	\$388,486	\$425,657	\$462,829
8	\$371,255	\$414,170	\$457,085
9	\$353,681	\$402,454	\$451,227
10	\$335,754	\$390,503	\$445,251
11	\$317,469	\$378,313	\$439,156
12	\$298,819	\$365,879	\$432,940
13	\$279,795	\$353,197	\$426,598
14	\$260,391	\$340,261	\$420,130
15	\$240,599	\$327,066	\$413,533
16	\$220,411	\$313,607	\$406,804
17	\$199,819	\$299,879	\$399,940
18	\$178,815	\$285,877	\$392,938
19	\$157,392	\$271,594	\$385,797
20	\$135,539	\$257,026	\$378,513
21	\$113,250	\$242,167	\$371,083
22	\$90,515	\$227,010	\$363,505
23	\$67,326	\$211,550	\$355,775
24	\$43,672	\$195,781	\$347,891
25	\$19,546	\$179,697	\$339,849
26		\$163,291	\$331,645
27		\$146,557	\$323,278
28		\$129,488	\$314,744
29		\$112,078	\$306,039
30		\$94,319	\$297,160
31		\$76,206	\$288,103
32		\$57,730	\$278,865
33		\$38,884	\$269,442
34		\$19,662	\$259,831
35		\$55	\$250,028
36			\$240,028
37			\$229,829
38			\$219,425
39			\$208,814
40			\$197,990

Source: Author's calculations

Retirement Income Menu

Assuming a 4% withdrawal rate.

40-Year Maximum Retirement Period	Fixed 2% Annual Portfolio Return			Variable Portfolio Return (based on 1,500 simulations)		
	Fixed Annual Withdrawal of \$20,000, No COLA Withdrawal is 4% of starting balance	Variable Annual Withdrawal Withdrawal is 4% of year-end portfolio balance	Annual Withdrawal Determined by RMD Starts at age 70 ½	Fixed Annual Withdrawal of \$20,000, No COLA Withdrawal is 4% of starting balance	Variable Annual Withdrawal Withdrawal is 4% of year-end portfolio balance	Annual Withdrawal Determined by RMD Starts at age 70 ½
Column →	Column A	Column B	Column C	Column D	Column E	Column F
40-Year Annualized Return (%)	2	2	2	7.49	7.49	7.49
40-Year Standard Deviation (%)	0	0	0	13.79	13.79	13.79
Years with Positive Return (%)	100	100	100	66.2	66.2	66.2
Number of Years Portfolio Survived (40 max)	35	40+	40+	39.5 Avg.	40+	40+
Least Number of Years Portfolio Survived	35	40+	40+	14	40+	40+
Did Portfolio Survive 10 Years?	Yes	Yes	Yes	Yes	Yes	Yes
Total Amount Withdrawn in 10 Years (\$)	200,000	185,927	196,304	200,000	261,357	267,535
Average Annual Withdrawal over 10 Years (\$)	20,000	18,593	19,630	20,000	26,136	26,753
Portfolio Balance After 10 Years (\$)	390,503	405,214	395,088	830,196	748,311	749,274
Did Portfolio Survive 20 Years?	Yes	Yes	Yes	99.7% of time	Yes	Yes
Total Amount Withdrawn in 20 Years (\$)	400,000	336,607	413,146	399,800	653,656	830,185
Average Annual Withdrawal over 20 Years (\$)	20,000	16,830	20,657	19,990	32,683	41,509
Average Annual Withdrawal in Years 11-20 (\$)	20,000	15,068	21,684	19,980	39,230	56,265
Portfolio Balance After 20 Years (\$)	257,026	328,396	244,298	1,574,156	1,119,140	891,572
Did Portfolio Survive 30 Years?	Yes	Yes	Yes	97% of time	Yes	Yes
Total Amount Withdrawn in 30 Years (\$)	600,000	458,723	602,331	596,493	1,235,095	1,759,237
Average Annual Withdrawal over 30 Years (\$)	20,000	15,291	20,078	19,883	41,170	58,641
Average Annual Withdrawal in Years 21-30 (\$)	20,000	12,212	18,918	19,669	58,144	92,905
Portfolio Balance After 30 Years (\$)	94,319	266,141	89,442	3,239,113	1,664,531	646,287
Did Portfolio Survive 40 Years?	No	Yes	Yes	95.7% of time	Yes	Yes
Total Amount Withdrawn in 40 Years (\$)	700,000 + 55	557,689	691,221	789,200	2,099,452	2,598,384
Average Annual Withdrawal over 40 Years (\$)	20,000 for 35 yrs	13,942	17,281	19,730	52,486	64,960
Average Annual Withdrawal in Years 31-40 (\$)	20,000 for first 5 yrs 0, for last 5 yrs	9,897	8,889	19,271	86,436	83,915
Portfolio Balance After 40 Years (\$)	0	215,688	9,613	6,998,398	2,481,820	150,744

Source: Author's calculations

PORTFOLIO

for the RMD-governed retirement portfolio, the outcome over 40 years will be astonishingly similar to having chosen a fixed annual withdrawal of \$20,000 – which was 4% of the original starting balance.

Now, the right-hand side of this chart reflects a retirement portfolio that is invested in a diversified multi-asset portfolio; which offers considerable uncertainty. The results in this analysis were derived from 1,500 iterations of a Monte Carlo simulation of retirement portfolio returns.

The average annualized 40-year return after 1,500 simulations was 7.49%, with a 40-year standard deviation of returns of 13.79%. The randomized portfolio had positive returns in 66.2% of the years. These performance characteristics were chosen to represent the type of volatility that has been observed in capital markets over the past 20-plus years.

PORTFOLIO SURVIVAL

In a world of uncertainty, we observe that the retirement portfolio survived at least 10 years in all 1,500 simulations. The average annual withdrawal in the first 10 years was highest using the RMD guidelines (\$26,753 in Column F), but only slightly higher than if withdrawing 4% of the portfolio balance each year (\$26,136 in Column E).

What about 20 years? The portfolios lasted 99.7% of the time if withdrawing \$20,000 each year. In that scenario, the average ending balance was \$1,574,156 after 20 years – far larger than any of the withdrawal scenarios if the portfolio was earning a fixed 2% annual return.

And 40 years? The portfolio survived in 95.7% of the simulations, when withdrawing \$20,000 each year (4% of the starting portfolio balance) with an average ending balance of just

under \$7 million. The average annual withdrawal over the full 40 years was \$19,730 (or just slightly below the \$20,000 figure, which accounts for the rare cases when the portfolio was liquidated before the 40th year).

If, however, the annual withdrawal was variable (in this case 4% of the year-end balance each year), the portfolio lasted the full 40 years 100% of the time.

The average annual withdrawal over the 40-year period was \$52,486 and the average ending balance in the 40th year was just under \$2.5 million. Clearly, this approach gives the retiree more spending power than with a fixed annual withdrawal of \$20,000.

The RMD is different: its job is to largely liquidate (and tax) the portfolio before the retiree is age 110. And it does. But, it also guarantees the portfolio will not be empty before that age.

The average annual withdrawal over the 40-year period was \$64,960. But, it's worth noting that the RMD average withdrawal in the first 10 years (ages 70 to 80) was \$26,753 – very close to the variable annual withdrawal of 4% of \$26,136. Then, for the ages of 81 to 90 the average annual RMD withdrawal was \$56,265 – far higher than any other amount in that same row of the table. For the ages of 91 to 100, the average annual RMD withdrawal was \$92,905. The next closest amount was \$58,144.

Accelerated withdrawals using RMD guidelines take a toll. After 40 years, the average ending balance in the RMD-governed portfolio was \$150,744, compared with nearly \$7 million in the fixed annual withdrawal approach and \$2.48 million in the variable withdrawal scenario that withdrew 4% of the year-end portfolio balance each year.

In summary, retirees who crave

certainty may want to consider a fixed return portfolio combined with a variable withdrawal.

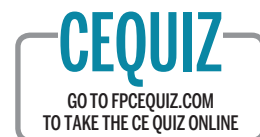
An important point is that the variable annual withdrawal will result in declining withdrawals from the portfolio every year if the fixed return of the portfolio is lower than the withdrawal percentage (which was the case in this analysis). The benefit in choosing a variable annual withdrawal (based on a percentage of the portfolio's value at the end of each year) is that you will still have money remaining after 40 years.

MAXIMIZING INCOME

Conversely, if a client chooses a variable return retirement portfolio (such as by investing in a broadly diversified collection of asset classes) and she wants to maximize her retirement income, she should choose a variable annual withdrawal based on a percentage of the portfolio's value, rather than a fixed annual withdrawal.

She'll need to understand that an annual cash withdrawal based on a percentage of the portfolio's value can go down in some years. In other words, if the portfolio experiences a loss, the annual withdrawal will be reduced. While this may be frustrating, it serves to protect the portfolio from early failure. So, to the question "will I run out of money?" the answer is generally no. At least, not for 40 years.

The real key is how much money does the client need yearly? If using 4% of the portfolio balance will be sufficient, then a diversified multi-asset variable-return portfolio is very compelling. **FP**



Craig L. Israelsen, Ph.D., a *Financial Planning* contributing writer in Springville, Utah, is an executive in residence in the personal financial planning program at the Woodbury School of Business at Utah Valley University. He is also the developer of the 7Twelve portfolio.

When Clients Misperceive Risk

Even if we have an accurate measure of investors' risk tolerances, that doesn't mean they won't overreact to a painful decline in the markets.

BY MICHAEL KITCES

BEFORE INVESTING CLIENT ASSETS, ADVISORS ARE required to assess a client's risk tolerance. If an investor takes on more risk than they can endure, they are likely to lose more money than they can stomach when the inevitable bear market comes.

And even when the markets recover, there's a risk that the investor will panic sell at the bottom.

Of course, if all investors were astutely aware of their own risk tolerance, the need to assess would be moot; clients could simply self-regulate their own portfolio and behaviors. The caveat, though, is that not all investors are cognizant of – or may outright misjudge – their own comfort level until it is too late.

ALIGNING PERCEPTION

We see the key problem of investors selling at the bottom. Investors do not necessarily perceive the risks of a bull market because it often takes a bear market – or at least a severe correction – to align perception with reality.

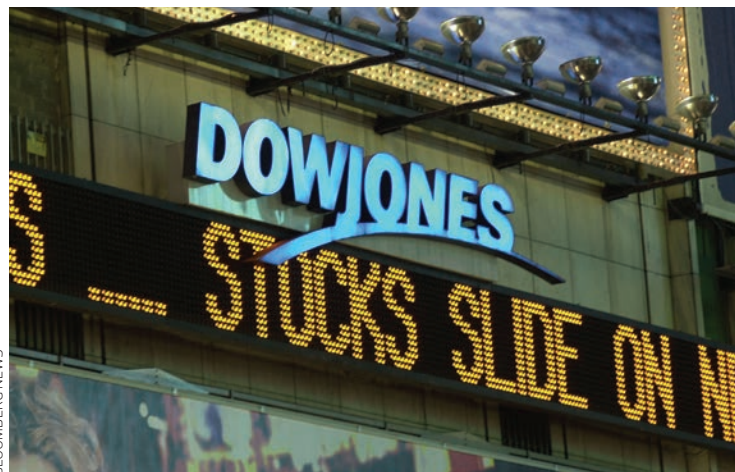
Some clients are especially prone to misperceiving risks (and thus tend to make frequently-ill-timed portfolio changes). Or viewed another way, while some clients are quite good at maintaining composure through market ups and downs, others have poor risk composure.

Understanding who problem clients might be is not really about assessing their risk tolerance, per se, but trying to determine their risk composure and the stability of their risk perceptions.

RISK COMPOSURE

Unfortunately, at this point no tools exist to measure risk composure – beyond recognizing that clients whose risk perceptions vary wildly over time are likely to experience challenges staying the course in the future.

Perhaps it's time to broaden our understanding and assessment of risk composure because, in the end, it's the investor's ability to consistently understand and correctly



Clients often misjudge their comfort level around risk.

perceive the risks they're taking that really determines whether they are able to effectively stay the course.

COMFORT ZONES

Conservative investors often don't sell risky portfolios until a perceived risk pushes them beyond their comfort zone, which is important for two reasons.

First, it reveals that the key issue isn't gaps between the investor's portfolio and their risk tolerance per se, but the gap between the perceived risk of the investor's portfolio and their risk tolerance.

Second, it implies that even with appropriate portfolios, investors could make bad investment decisions if they misperceive the risk they're taking.

Imagine a client who is very conservative. It's 1999, and he has watched from the sidelines as tech stocks have skyrocketed. Year after year, he has seen technology equities beat cash and bonds like clockwork. The client grows convinced that there's no risk to investing in technology stocks – they only ever go up. In this context, if you were a very

PORTFOLIO

conservative bond investor and became convinced that tech stocks were going to beat bonds every year, what would you do? Why, you'd put all your money in tech stocks.

Once tech stocks do finally crash the following year, however, the conservative investor will probably sell and potentially lock in a substantial loss.

TOLERANCE LEVELS

The key point here is that the investor didn't suddenly become more tolerant of risk in 1999, only to become intolerant when the crash began a year later. Rather, the investor misperceived the risk in 1999 and then adjusted his perceptions to reality when the bear market showed up in 2000.

It's the same pattern that played out with housing in 2006. Or tulips in 1636. It's not risk tolerance that's unstable, in other words, but risk misperception.

Now imagine a client who is extremely tolerant of risk. She's a successful serial entrepreneur who has repeatedly made calculated bets and profited from them. Appropriate to her tolerance, her portfolio is invested 90% in equities.

But suddenly, a major market event akin to the 2008 crisis occurs, and she becomes convinced that the whole system is going to break down.

As a highly risk-tolerant investor, what

would the appropriate action be if you were very tolerant of risk, but convinced the market was going to zero? You'd sell all your stocks – not because you aren't tolerant of risk, but because not even a risk-tolerant investor wants to own an investment they're convinced is going to zero.

The key point again is that the investor's risk tolerance isn't necessarily changing in bull and bear markets. She remains highly tolerant of risk. Rather, her perceptions are changing – and her misperception that a bear market decline means stocks are going to zero actually causes the problem behavior. It consequently leads the client to want to sell out of the portfolio, even though it actually was aligned appropriately to her risk tolerance in the first place.

RASH DECISIONS

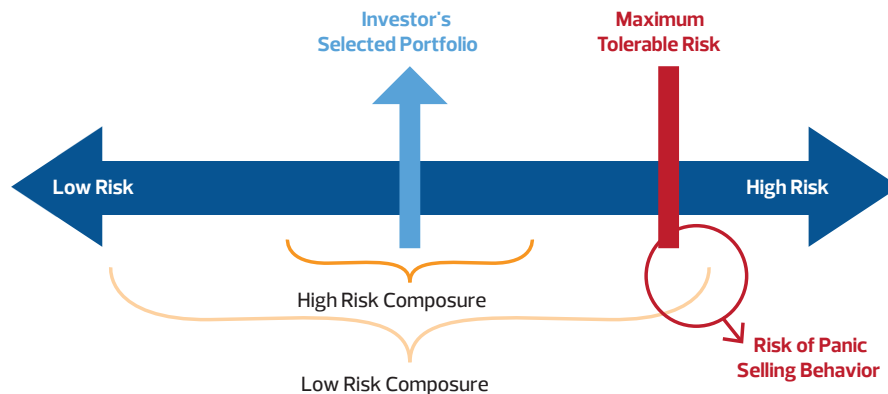
Every experienced advisor is aware of a small subset of clients who are especially prone to making rash investment decisions.

They're the ones who send emails asking whether they should be buying more stocks every time the market has a multimonth bull market streak. And they're the ones who call and want to sell stocks whenever there's a market pullback and the scary headlines hit CNBC and the newspapers.

In other words, some clients have espe-

It often takes a bear market to align an investor's perception of risk with reality.

Low Risk Composure Makes Tolerable Portfolios Seem Scary



Note: Risk composure = Clients' perceived risk of their selected portfolio

Source: Michael Kitces

cially unstable perceptions of risk. The cycles of fear and greed mean that most investors swing back and forth in their views of risk at least to some degree.

BEHAVIORAL BIASES

But while the risk perception of some clients swings like a slow metronome, for others it's more like a seismograph.

It's those latter clients who seem to be especially prone to the kinds of behavioral biases that cause us to misperceive risk.

They are especially impacted by the so-called recency bias, where we tend to extrapolate the near-term past into the indefinite future – i.e., what went up recently will go up forever, and what went down recently is going all the way to zero. They may also be prone to confirmation bias, which leads us to selectively see and focus on information that reaffirms our existing – i.e., recency – bias.

OVERCONFIDENCE

And for many, there's also an overconfidence bias that leads us to think we will know what the outcome will be, and therefore we will want to take action in the portfolio to control the result.

In essence, some clients appear to be far more likely to be influenced by various behavioral biases. Others are better at maintaining their risk composure and not having their perceptions constantly fluctuate with the latest news, nor becoming flustered by external events and stimuli.

This is important because it means that clients with low-risk composure are actually most prone to exhibit problem behaviors regardless of whether they're conservative or aggressive investors.

After all, an aggressive client with good risk composure may see a market decline as just a temporary setback, while an aggressive client with bad risk composure may see a market decline and suddenly expect it's just going to keep declining all the way to zero.

In each case, both clients are aggressive. The "right" portfolio would consequently be an aggressive one given their risk tolerance, presuming it aligns with their risk capacity. But the client with bad risk composure will

need extra hand-holding to stay the course, because they are especially prone to misperceiving risk based on recent events, and thinking the portfolio is no longer appropriate, even if it is.

Similarly, if two clients are very conservative but have different risk composes, the one with high risk composure should be able to easily stay the course with a conservative portfolio and not chase returns, recognizing that even if the market is going up now, it may well experience market declines and volatility later.

Meanwhile, the conservative client with bad risk composure is the one most likely to misperceive risk, leading to return chasing as they become convinced that a bull market in stocks must be a permanent phenomenon of guaranteed-higher-returns – only to come crashing back to reality when there is a decline in the market.

The key point here is that both conservative and aggressive clients can have challenges staying the course in bull and bear markets even if their risk tolerance remains stable. Some people simply have greater ability to maintain their cool through market cycles, while others do not.

And it's those low-risk composure investors who are more likely to misperceive risks – to the upside or downside – that tend to trigger potentially ill-timed buying and selling activity.

CAN'T WE MEASURE?

If only we could figure out how to accurately measure risk perception and risk composure, we could identify which investors are most likely to experience challenges in sticking to their investment plan.

Because again, it's not merely about the investor's risk tolerance and whether they are conservative or aggressive with a properly aligned portfolio in the first place, but how likely they are to correctly perceive the risks in the portfolio.

This is also why it's so crucial to start out with a psychometrically validated risk tolerance assessment tool – though, unfortunately, few of today's risk tolerance questionnaires are suited for the task.

Perhaps it's time not only for a tool to measure risk tolerance, but also one that either measures risk composure or at least provides an ongoing measure of risk perception.

RISK TOLERANCE QUESTIONNAIRE

Imagine two prospective clients enter your office. Both have aggressive portfolios and say they're very comfortable with the risks they're taking.

How do you know if the investors are truly risk tolerant, or if they're actually conservative investors who have misjudged the risk in their portfolios?

The answer: Give them both a high-quality risk tolerance questionnaire and see if their portfolios actually do align with their risk tolerances.

If the risk tolerance questionnaire is completed, and investor A scores very aggressive while investor B scores very conservative, it becomes clear that investor A is accurately assessing risk and has the appropriate portfolio, while investor B has become risk-blind and needs a different portfolio (not to mention an education on how much risk they are actually taking).

Notably, though, while even this approach can identify clients who are misperceiving risk, there is still no tool that directly measures risk composure or at least provides an ongoing measure of risk perception (as by definition, those with unstable risk perception over time are the ones with poor risk composure).

For instance, clients might be regularly asked what their expectations are for market returns.

The expected return itself – and especially an inappropriately high or low return – is an express sign of risk misperception, and those who expected returns for stocks and bonds to fluctuate wildly over time would be scored as having low risk composure as well.

BIODATA APPROACH

Alternatively, perhaps there is a way to ask clients more general questions that assess ongoing risk perceptions, or simply assess risk composure up front.

This might include a biodata approach, asking them whether historically they've

tended to make portfolio adjustments in bull and bear markets – which at least would work for experienced investors.

Other questions might ask whether they like to take in current news and information to make portfolio changes or try to measure other similar behavior patterns that suggest they are more actively changing risk perceptions with new information and therefore have low composure.

The bottom line is simply to recognize and understand that in times of market volatility, what's fluctuating is not risk tolerance itself but risk perception, and moreover that risk tolerance alone may actually be a poor indicator of who is likely to need hand-holding in times of market volatility.

THE MISSING LINK

After all, if it was just about risk tolerance, then any investor whose portfolio was in fact aligned with their tolerance should be "fine" in staying the course.

But in reality many clients aren't, not because their portfolio is inappropriate for their tolerance, but because they misperceive the risk they're taking.

This causes them to either want to buy more (in a bull market that seems like a sure bet), or sell in a bear market (because who wants to own an investment you believe is going to zero, regardless of your risk tolerance).

Of course, a portfolio that is not aligned to the investor's risk tolerance will clearly be a problem.

But the missing link is that even for those with proper allocations, those with low risk composure will still struggle with their investment decisions and behaviors.

And to the extent we can figure out how to identify clients who risk perceptions are misaligned with reality, and who have low risk composure and are prone to such misperceptions, the better we can identify who are actually most likely to need help via a financial advisor, or other interventions to stay the course.

FP

Recognize and understand that, in times of market volatility, what's fluctuating is not risk tolerance itself but risk perception.

CE QUIZ

FEBRUARY 2018

VISIT FPCEQUIZ.COM TO TAKE *FINANCIAL PLANNING'S* CE QUIZ.

FROM: DANGEROUS GENERALIZATIONS

1. What will the approximate estate tax exemption be for a couple in 2018?

1. \$14.4 million
2. \$22.4 million
3. \$26.5 million
4. \$21 million

2. What will the approximate 2018 exemption be for a single filer?

1. \$11.2 million
2. \$10.5 million
3. \$7.2 million
4. \$8.4 million

FROM: DO-IT-YOURSELF PENSION MANAGING

3. A client has \$500,000 in a retirement account. Which portfolio and withdrawal strategy should see the largest balance remaining at the end of 40 years?

1. Fixed annual withdrawal of \$20,000 with a portfolio that has a 2% fixed return.
2. Variable annual withdrawal of 4% of the year-end balance of a 2% fixed-return portfolio.
3. Variable annual withdrawal of 4% of the year-end balance of a variable-return portfolio (e.g., a broadly diversified, multi-asset class portfolio).
4. Fixed annual withdrawal of \$20,000 for a variable-return portfolio.

4. In the same scenario, which strategy should see the lowest balance remaining?

1. Fixed annual withdrawal of \$20,000 of a variable-return portfolio.
2. Annual withdrawal by RMD of a portfolio that has a 2% fixed return.
3. Annual withdrawal by RMD of a variable-return portfolio.
4. Fixed annual withdrawal of \$20,000 for a portfolio with a 2% fixed return.

FROM: THE FAULTS OF A POPULAR RETIREMENT SAVING TOOL (online only)

5. If a client contributes \$300 a month to an aggressive, 8%-return portfolio, how far along toward a goal of \$1 million in retirement funds will they be in 23 years?

1. 50%
2. 40%
3. 25%
4. 35%

FROM: THE RIGHT WAY TO PROJECT FUTURE COLLEGE EXPENSES (online only)

6. What is the typical college inflation rate assumed by financial planners?

1. 3%
2. 4%
3. 6%
4. 2%

7. The actual five-year real change in published tuition, fees, and room and board from the 2011-2012 school year to 2016-2017 was how much, annually, for private four-year colleges?

1. 3.5%
2. 4%
3. 5.2%
4. 2.4%

8. During the same time span, what was the real change for public colleges?

1. 1.9%
2. 2.2%
3. 3.2%
4. 4.4%

FROM: THIS TIME-SAVING TRICK GETS ADVISORS FIRED. DON'T DO IT (online only)

9. If an advisor has a client sign a blank form, then fills out the form for the client in an effort to be helpful, which FINRA rule is the advisor violating?

1. FINRA Rule 3000
2. FINRA Rule 2010
3. FINRA Rule 4500
4. There is no FINRA rule violation

FROM: DO ADVISORS NEED THEIR FIRM'S CONSENT TO OPEN A 529? (online only)

10. Under FINRA Rule 3210, an advisor needs written consent from their firm for which activity?

1. Maintaining a brokerage account at another member firm or financial institution either before or after they were employed by the firm.
2. Maintaining a brokerage account at another member firm or financial institution only after they became employed by the firm.
3. Opening a 529 for their child.
4. Engaging in outside business activities.

Financial Planning offers its Continuing Education Quiz exclusively online at FPCEQuiz.com.

To earn one hour of continuing education credit from the CFP Board of Standards, please visit our website and answer the questions above. Planners must answer eight out of 10 questions correctly to pass. Credit will count under CFP Board subject A: financial planning process/general principles. The deadline for participation is Feb. 28, 2019.

In addition, the Investments & Wealth Institute, formerly the Investment Management Consultants Association, has accepted this quiz for CIMA, CIMC and CPWA CE credit. Advisors must answer eight out of 10 questions correctly to pass. The deadline is Feb. 28, 2019.

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Financial Planning



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*Source: www.cnbc.com/2015/02/02/sors-have-such-a-hard-time-reaching-women.html / **Advisors that meet our 17-point criteria can earn the Women's Choice Award.



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SELFIE

Fighting the Fear of Change

Adopting the latest fintech costs money and takes time, but the benefit far outweighs the initial cost.

BY NINA O'NEAL



LAST MARCH, I RECEIVED A CALL FROM MY SISTER. “Your building is burning down,” she said. “Turn on the news.” I watched in horror as a massive fire destroyed two tall apartment buildings in downtown Raleigh, North Carolina, just one block from my firm’s office. Despite the shocking footage, I told her: “If the building burns down, we’ll lose some computers and desks – it’s fine. We can operate business as usual tomorrow.”

Over the last several years, our advisory firm has made an effort to become a completely cloud-based fintech office. In the event of any emergency, any employee can work remotely from a phone, laptop or tablet. As we’ve seen with some of the natural disasters that have ravaged our country in recent months, implementation of technology that allows for business continuity is crucial – and fully possible.

With the evolution of fintech, firms and advisors can easily implement CRM and trading systems, financial planning and risk management software, and data storage applications. Yet some advisors think they don’t need new technology. Others hesitate because of cost pains, lack of knowledge and a concern about being able to integrate new tools into their practice. All of these excuses are indicative of one thing – a fear of change.

In fact, in a 2016 PWC survey, less than half of respondents said they put fintech at the heart of their business strategy – a shockingly low percentage given the advanced technology available today. It’s also a lost opportunity.

Last year, our firm changed broker-dealers because we needed more streamlined technology. Following the integration process, we realized we didn’t have to replace a staff member, who had previously left the firm.

The new technology also saved time as we cut down on

hours spent preparing for client meetings. Moreover, cloud-based technology eliminated the need for clunky equipment and reduced commercial real estate expenses. Of course, technology costs money and implementation takes time, but the benefit far outweighs the initial cost.

NAVIGATING UNCHARTERED WATERS

For advisors worried about making the transition to a new suite of technology, consulting firms, BDs and industry conferences are all available as resources to help navigate uncharted waters. Utilize their network and consider working with consulting firms to gain a comprehensive understanding of the best technology integrations available.

Attending industry conferences helps. Most of these national or regional conferences have sponsor booths where fintech companies will provide demonstrations. Hands-on interactions help examine available options to create the most effective technology stack for your firm’s needs.

Our firm has already implemented such solutions as Riskalyze for risk management software, eMoney Advisor for financial planning and client aggregation, and Dropbox Business for cloud file storage.

Keep in mind that practices may soon need to be cloud-based. In fact, FINRA Rule 4370 requires firms to create and maintain written business continuity plans relating to a significant business disruption. In 2016, the SEC issued a proposal to amend Rule 204-2 to require RIAs to make and keep all business continuity and transition plans currently in effect.

The implementation of cloud-based technology, particularly as it relates to data storage, helps to satisfy the data backup and recovery element of these rules. **FP**

Nina O’Neal is an investment advisor and partner at Archer Investment Management in Raleigh, North Carolina. Follow her on Twitter at @noneal510.

To submit a Selfie commentary, email fpeditor@sourcemediacom. Post your comments online at financial-planning.com.

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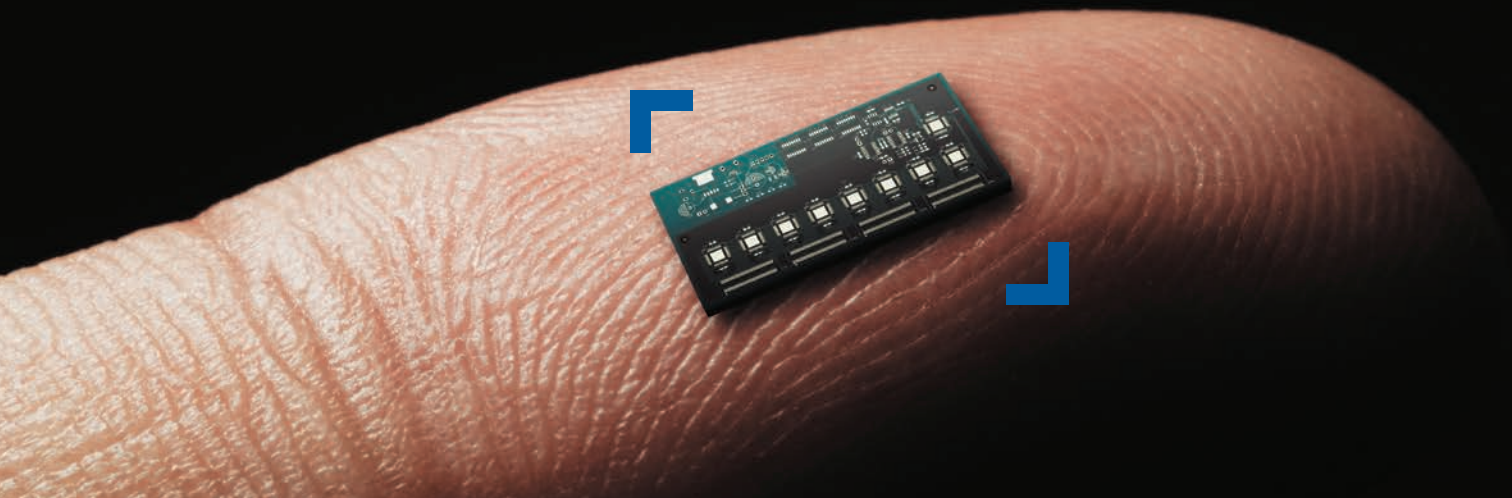
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