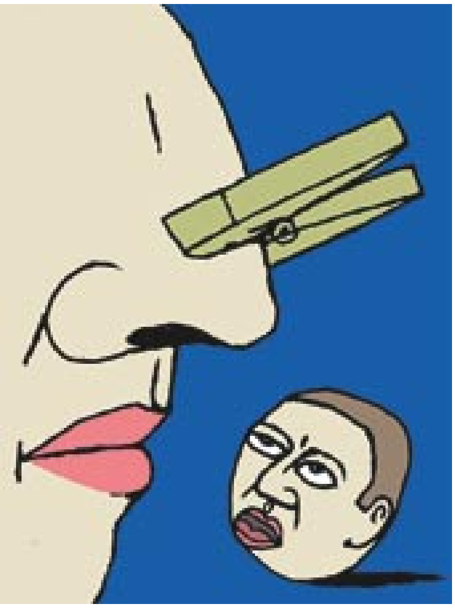
The Integrity Test

Still searching for that mark of true independence? Offer commissioned products? Espouse only fees? Maybe the answer is somewhere in the middle.

Mary Rowland



Illustrations by Scott Menchin

Since last fall, when Bloomberg Press published *In Search of the Perfect Model: The Distinctive Business Strategies of Leading Financial Planners,* I've been invited to do a number of presentations on what makes a financial-planning model "perfect." No model is ideal, but probably the most difficult issue advisers face in building one is whether they will sell both products and advice. In all the meetings I've attended where wealth managers struggled to define their mission and their market share, the issue of defining what is okay to sell is a real conundrum. Among independent advisers—whose work has long been my main focus—this debate is mostly settled. They don't sell products. Among bankers and financial institutions that push their own products on clients, the debate isn't even held. Still, for the many planners that find themselves somewhere in the middle of that spectrum, the question is a difficult one: must selling products and selling advice be mutually exclusive?

The financial media in the United States have weighed in on both sides of the long-standing debate on the wisdom of selling products and the message it may send about the integrity of a planner's advice. For 20 years, advisers in the United States have chased after some moniker that would characterize them as independent. By the early 1990s, the National Association of Financial Advisors (NAPFA) had done a pretty good job of persuading the press that "fee-only," was synonymous with independent judgment. Although the term "fee-only" clearly isn't enough to distinguish a good adviser from a poor one, its use brought the issue of fiduciary responsibility to the surface along with concerns about conflict of interest and responsibility to clients.

For a time, integrity seekers sought an answer in licensure, namely, the certified financial planner designation. If the CFP designation could be made to command the same respect as the certified public accountant (CPA) or Juris Doctor (J.D.) title, planners reasoned, the label would send a signal to consumers that they're working with a top-notch adviser. And are they? Yes—that is, if you measure success by consumer perceptions, which means, of course, the press. The CFP and "fee" labels now make the list in consumer stories about how to identify a good financial adviser. But if you're measuring according to whether the planner does what's best for clients, the answer is—not necessarily.

In the mid-'90s, many eager planners converged on the high end of the market that serves clients who pay for a vast array of services under the assets under management model. For this group of independent advisers to the rich, the title wealth manager was bandied about, and books like Harold Evensky's *Wealth Management: The Financial Advisor's Guide to Managing Your Client's Assets* (McGraw-Hill) and Ross Levin's *The Wealth Management Index: The Financial Advisor's System for Assessing & Managing Your Client's Plans & Goals* (McGraw-Hill) helped authenticate the new moniker. Trouble is, there's nothing to prevent brokers or insurance agents from calling themselves wealth managers. So, like the earlier labels, this definition of wealth management made things even blurrier.

It's small surprise then that the press has latched on to Sheryl Garrett's fee-by-the-hour model as the new mark of absolute independence and objectivity. Garrett and the advisers in her network charge an hourly fee and provide objective advice. It's a clean model, but it's not going to be the only model that ensures uncompromised services and deserves to be talked about. At least I hope it's not. How, for example, do wealth managers like David Diesslin in Fort Worth, Tex., and Charlie Haines in Birmingham, Ala., set themselves apart? What message do they send about who they are? Like many in the industry, these advisers' practices have evolved into what's known as a multifamily office. What they're still after is a definition that clearly marks them as independent and client-centered. Certainly, the family office of a large wealthy family would put its family clients first and would not attempt to push products. But is multifamily office a label that necessarily ensures that a planner is independent? Maybe not. Maybe objectivity can be found just as readily in a practice that sells both products—even commissioned ones—and advice. I believe it can, but only if the planner has the client's needs in mind. If the recommendation is mostly about getting the commission, he's barely a rung above the banker on the integrity ladder.

Last fall, I went to Birmingham, England, to speak with members of the Society of Financial Advisors (SOFA). I was excited to learn that these advisers are independent. In England, there's a clear distinction between what might be called the captive agents of a broker or insurer or bank and the members of SOFA, who offer products from a wide variety of vendors. But I also learned that the financial-services establishment is unhappy with the independence this label signifies and that the law will soon be changed so that SOFA members will be on a more level playing field with captive agents. Isn't that always the way with regulation? It answers the needs of those with the most money and the best lobbyists.

Up close, it's not difficult to tell the difference between people who are trying to sell products to feather their nests and people who use them because they're right for the client

As for identifying the planner—whether here or across the ocean—who puts his client's needs first, I can't offer a foolproof screen, but reporters are good at evaluating people one-on-one. It's the smell test. Up close, it's not difficult to tell the difference between people who are trying to sell products to feather their nests and people who use them because they're truly right for the client.

One planner who has passed my test is Gillian Cardy, whom I met in England. At the end of my talk, Cardy raised her hand to say that many British planners are skeptical about a fee-by-the-hour model, arguing that it wouldn't work in the United Kingdom. Other planners in the audience agreed, insisting that because regulatory costs are so high, an hourly fee could never be large enough to cover them. But isn't that just the kind of argument we've been hearing all along against independence? Tack your fee onto a product spread and be done with it. Don't tell the client.

Cardy impressed me so much that I followed up with her after returning home to find out what kind of career path she'd had. Cardy went to work at an insurance company when she finished college. "It was just a job to do while I thought about going to teacher training college," says Cardy. But instead she went back to school for an M.B.A. and became a "tied/direct sales adviser" to the same insurer. "I discovered I liked advising but couldn't bear being limited to discussing the products of only one company, so I wanted to become independent," she explains—in words I've heard from dozens, if not hundreds, of American planners. "The move toward financial planning came as I realized that product sales are not where it's at, either for clients or for advisers who aren't comfortable with sales." Cardy gradually came to understand that she could add value by giving advice rather than by selling product. "To properly add value to clients and to be able to charge for my time with confidence," says Cardy, "I need to be highly qualified. That's what sets me apart from the competition and makes it easier to say that fees pay for professional knowledge."

In her work at the insurance company, Cardy saw that many of its new clients had no existing investments and that advisers would typically make a lot of commission from those clients. "The commission I made was often vastly in excess of the cost of the time we spent on those clients," she says. Such concerns are what separates an independent adviser from a salesperson. How likely is a salesperson to be troubled that a commission is too large? Cardy's clients were told that the excess commission would be "held over" to pay for advice in the future, but "the business was not structured to ensure that advisers would have the time to deliver that promised work," she explains. The problem on the other side of the coin "was doing work that relied on sales [and] then not getting paid if no products were bought."

So Cardy arrived at what appeared the only logical conclusion: "It seemed ethical and commercially sensible to set things up so that clients pay for the work that I do when I do it," says Cardy. She set up her own business in August 1998, then added an administrator, and soon another, along with four other advisers and a part-time administrative assistant. Cardy was interested in the hourly fee structure and moved toward it gradually. Even so, she accepts commission if a client prefers that arrangement, but surplus commission "in excess of the cost of my time is reinvested into plans set up, reducing monthly premiums on protection policies, or reducing initial or annual charges on investments." When a task takes little time to implement but requires greater knowledge and preparation, she uses a "fee for the job" approach.

Cardy describes her practice as busy. "There's an increasing demand for strategic advice, long-term planning, and advice on meeting financial-planning goals and objectives," she says. What's more, these services generate income whether the market is up or down. "That kind of work also frees you to be more creative, to tell clients to use cash, to do nothing at all, or to use solutions that have nothing to do with insurance and financial-services products." Such creative planning, Cardy believes, is more common among wealth-management businesses in the United States than those in the United Kingdom, chiefly because American planners "are trying to find more and better ways to add value to client relationships." Cardy also rejects the idea that planning is required "only for high-net-worth clients," which prevails in her country.

> Maybe objectivity can be found just as readily in a practice that sells both advice and products—even commissioned ones. I believe it can.

Although Cardy may not agree with some of the thinking in her industry, she was able to take a step that's not available to many planners in the United States: moving gradually to a client-centered model without scrapping all commissions and starting anew with fees. Although the fee-only model has its strengths, the NAPFA rules for membership tend to hamper the kind of creativity Cardy showed in building her practice. More important, though, I see Cardy as a smart, objective planner who wants to bring value to her clients and who has realized that selling products is not the way to do that. Still, regulation in the United Kingdom hasn't caught up with her. "The regulators are still focused on whether the most suitable product is sold," Cardy says, "not on the advice clients get from their advisers."

Perhaps that's because the effectiveness of the latter is too hard to measure. Maybe I'll have to teach them the smell test. Here's lesson one: Don't just find out whether the adviser recommends products; find out why.

Mary Rowland's book, In Search of the Perfect Model: The Distinctive Business Strategies of Leading Financial Planners *(Bloomberg Press), may be ordered at www.bloomberg.com/books or by calling 1-800-869-1231.*