As featured in the September 25, 2019
issue of WealthManagement.com

WealthManagement.com

By Jon Henschen

Anatomy of a Fiduciary-Friendly Broker/Dealer

More choices and lower pricing can protect your clients' interests and safeguard your practice.

Certified Financial Planners (CFPs) are required to adhere to a fiduciary standard when implementing financial plans, but to date, the same requirement has not been applied to investment advice. Effective October 1, 2019, CFPs will be required to adhere to a fiduciary standard on investment advice. Enforcement will begin on June 30, 2020.

How great an impact this will have on CFPs is unknown, as the CFP Board has no data on the number of CFPs not adhering to a fiduciary standard on investment advice. In our recruiting discussions with CFPs, we have certainly had discussions with financial planners that do not adhere to a fiduciary standard on financial advice and some that follow their own interpretation of a fiduciary standard ("fiduciary lite").

In an exchange of e-mails with **Michael Kitces**, financial planner, commentator and fierce advocate of fiduciary standards, I raised the topic of CFPs that do "fiduciary lite," and Michael was quick to respond, "A fiduciary standard isn't a philosophy of doing what's in the client's best interest. That's simply a philosophy of doing business. A fiduciary standard is a legal accountability for which you can be sued for damages for failing to do what's in your clients best interests, for which regulators require not only that the fiduciary make their clients whole for damages, but also require (to varying degrees) that the fiduciary proactively take steps to mitigate even the risk that a material conflict of interest might cause harm."

The Risk of a Material Conflict of Interest

Material conflict of interest is the salient point here, as we see independent broker/dealers swinging deeper in the direction of potential conflicts of interest. Here are some potential conflicts of interest we see on a broker/dealer level that can hinder an advisor from doing what is in the client's best interest on both investment choice and pricing:

Markups on third-party money managers—Many b/ds mark up third-party money-manager management fees anywhere from 2½ basis points to as high as 25 bps. We've talked to advisors that called outside registered investment advisor firms like Schwab and asked them if they offered the money manager and what management fee they charged, only to discover the management fee ran 20 bps less.

Platform fees—These are fees meant to penalize advisors for not putting their assets in the broker/dealer's more profitable silos. If you want to custody advisory assets at Schwab, TD Ameritrade or Fidelity IWS, you may have a 10 bp platform fee imposed on you because these firms profit more if you have those assets held in their clearing firm. If you hold third-party money managers direct at the manager, you may incur an additional 5 bp platform fee for the same reason.

Proprietary advisory platforms—Numerous larger b/ds and some of the midsize b/ds are hitting profitability gold with in-house advisory platforms, with many of these firms tightening the thumbscrews on advisors to park assets in their more profitable internal platforms. B/ds are not obligated to mitigate potential conflict of interest, but CFPs are, which is why anything that is proprietary is potentially in conflict with their client's best interests, especially when b/ds offer special incentives like enhanced payouts and technology freebies to park a client's assets in their biggest profit centers.

Up-front forgivable note money—Up-front note money is crack cocaine to an advisor's base instinct of greed, and we see plenty of advisors changing their b/d based on the most up-front dollars offered. This inclination is about as far as you can get from a fiduciary standard.

Advisors Still Confused About What Fiduciary Standard Really Means

From an advisor's perspective, confusion still reigns as to what constitutes a fiduciary-friendly broker/dealer. To bring clarity, we are focusing on one of numerous firms we perceive as fiduciary-friendly. The firm, United Planners Financial Services of America, was formed in 1987 with 539 registered advisors, $8.1 billion of AUM and 60% of their revenue derived from advisory business. We asked United Planners President Michael Baker and Executive Vice President Sheila Cuffari-Agasi a few questions starting with, "How do you see your broker/dealer helping advisors to adhere to a fiduciary standard?"

According to Baker, "We have always maintained an open architecture philosophy and do not have proprietary products or platforms. Further, we do not mark up or have any revenue sharing with any of our investment advisory service providers. Given that we are 100% employee- and advisor-owned, we are not driven by a product manufacturer or private equity that may have other interests in mind. All these factors foster an environment in which we have eliminated the corporate level conflicts so advisors can operate their business and service their clients with a high degree of fiduciary standards."

Just Because Everyone Is Doing It Doesn't Make It Right

Wondering why United Planners hasn't gone the direction of corporate interests over clients, I asked, "What internal struggles did your firm go through in order to stand out for being fiduciary-friendly and not get caught up in the trappings of platform fees, excessive markups, proprietary advisory platforms and restricted choices?"

Cuffari-Agasi responded, "We had to prove that less of more, is more... without the overhead. Just because everyone else was doing it, it wasn't the right thing for us. About 12 years ago, the discussions began about the future of our industry and "where the puck was going." We talked about following the pack and were well aware of what other firms were doing. The trend line of traditional broker/dealer reps and hybrids moving to the Indy RIA space was already forming. We were able to create our space in that trend line. We turned our focus to the advisor, and what was best for their clients versus how to create the biggest profit. We knew we would be facing tough margins. We knew it was revolutionary and untested. We also knew it would help us attract the "ideal advisor" that shares a similar philosophy and is only looking at what is in the best interest of the client."

Stability in an Era of Private Equity and Acquisitions

Between insurance companies selling their broker/dealers, private equity largely filling that void and smaller firms selling to larger b/ds, we asked Baker, "How has United Planners addressed the issue of ownership stability and predictability in light of these changes?"

Baker responded, "United Planners was formed as a limited partnership by the founding partners primarily to avoid the potential of a corporate acquisition. Advisors appreciate coming to United Planners knowing that the fate and destiny of their broker/dealer and investment advisor does not lie in the hands of a few executives sitting around a boardroom table. But rather, it rests in the voting rights of over 150 advisors that qualify to be limited partners. The limited partnership structure makes a sale of the firm extremely difficult, if not impossible. We have been the recipient of a lot of quality advisors looking for that stability that is rare in an era of private equity and smaller firms being acquired by larger firms. We don't have to answer to shareholders, a sole owner or insurance company. We answer to our advisors."

CFPs that have not yet positioned themselves to a fiduciary standard on their investment advice may find their current b/d greatly conflicted in their ability to offer their clients what is in their best interests. Repositioning your clients into a fiduciary-focused true hybrid broker/dealer environment that brings more choices and lower pricing will not only safeguard your practice away from potential conflicts of interest and opaque pricing but also shield you from litigation-hungry securities attorneys.

PO Box 56, Marine on St. Croix
MN 55047
TEL 888.820.8107 651.433.3501

jon@henschenassoc.com
www.FindABrokerDealer.com
©2019 Henschen & Associates, LLC