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Social Security wreaking havoc with advisers

New rules are forcing them to rework retirement plans

By Mark Schoeff Jr.

Groundbreaking Social Security reform contained in budget legislation approved at breathtaking speed last week by Congress has financial advisers scrambling to rethink many of their clients' retirement plans.

The measure, passed by the Senate early Friday morning after being approved by the House earlier in the week, includes a provision that ends two popular Social Security claiming strategies: file-and-suspend and filing for a restricted claim of spousal benefits.

Both approaches generate higher benefit payouts for entitlement recipients and have been baked into retirement planning for many aging clients.

"We're going to have to take all of that, throw it in the trash can, and do the analysis all over again," said Michael Kalscheur, senior financial consultant at Castle Wealth Advisors. "That's going to be a huge task for planners to try to figure out how to make up for that shortfall in income."

NEW INCOME SOURCES

Clients will have to tap other financial resources to fill in the retirement-funding gap, said Robyn Hari, principal at Diversified Trust. That may include cutting personal expenses, continuing to work or depending more on their children.

"They may not have much time to make up that difference," Ms. Hari said. "They'll have to look at adjusting their standard of living or working longer."

Clients who have not saved enough for retirement and were depending on the extra boost from Social Security with these popular spousal claiming strategies will be hit the hardest.

"For somebody who was tenuous, this may be the thing that pushes them over the edge,"

Continued on Page 21

Death of the regional B-D

Many have either been acquired or are trying to become national firms

By Bruce Kelly

A.G. EDWARDS & SONS Inc., Advest Inc., McDonald & Co.

Twenty years ago, all were respected names in the securities industry — highly competitive regional broker-dealers whose advisers were employees, not independent contractors. Smaller than the full-service wirehouses, each firm had a retail or investment banking footprint in a particular part of the country: the Midwest, in the case of A.G. Edwards and McDonald & Co., and the Northeast in the case of Advest.

Now, like dozens of such once-respected regional firms, they have passed on. Two died relatively quietly, while one had a slow, painful death, switching hands multiple times before its name finally disappeared.

McDonald was sold to KeyCorp, the Cleveland bank holding company, in 1999, a year before the dot-com bubble burst. It was eventually sold to UBS AG in 2007.

A.G. Edwards was acquired in 2007 by Wachovia Corp., which was in turn was swallowed up by Wells Fargo during the credit crisis a year later.

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ISTOCK COMPOSITE

Richard Ketchum: Finra CEO says he'll stay on until a replacement is named.

BLOOMBERG

Finra CEO Ketchum set to step down

By Bruce Kelly and Mark Schoeff Jr.

Richard Ketchum's successor will have big shoes to fill.

Mr. Ketchum, 64, who announced his retirement as Finra's chairman and chief executive last Friday, was known across the securities industry as accessible, approachable and interested in the broker-dealer members of the self-regulatory organization that oversees 4,000 brokerage firms and 643,000 registered reps.

Mr. Ketchum told Finra staff in an email that he was retiring, but would remain in his position until the Financial Industry Regulatory Authority Inc. had chosen his successor.

During industry meetings, Mr. Ketchum routinely held off-the-cuff conversations with compliance executives about specific problems they were having, often trading business cards and personal email to start a dialogue to address their concerns.

"It's easy to bash regulators over the years for the burden of regulation, but what's distinct about Rick is that he's kept his eye on the end goal of creating an effective market while also focusing on the role of consumer protection,"

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Inside

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Fidelity on hot seat

Massachusetts claims firm let at least 13 unregistered investment advisers trade on its platform.

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Oh Voya!

B-D is accused of cooking up Finra violations by a broker in retribution for her leaving the firm.

Page 5

Playing to the crowd

SEC finally approves rules allowing startups and small businesses to raise money by selling shares on the Internet.

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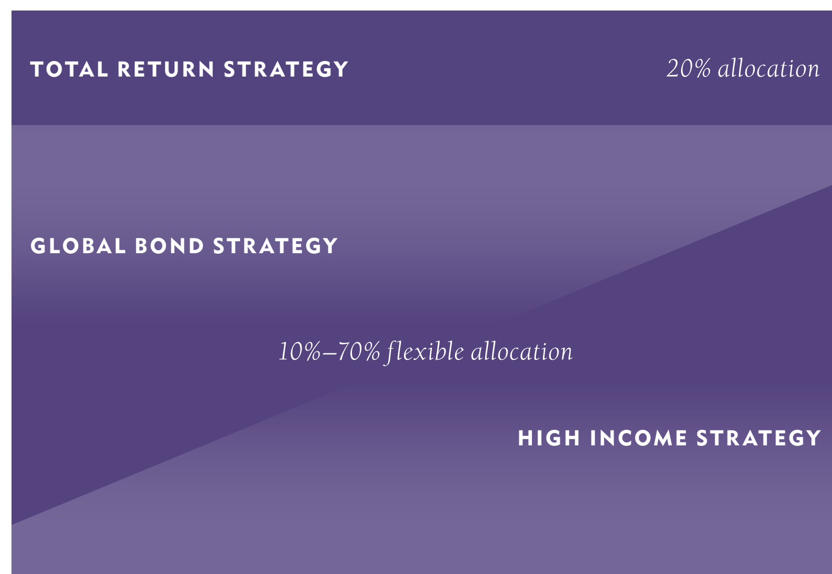

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EDITOR'S NOTE

Social Security is a specialty of ours

No doubt financial advisers across the country spent time last week talking with anxious clients about Social Security benefits.

That's because budget legislation approved by both the House and Senate contained a provision that puts a nail in the coffin of two hot Social Security claiming strategies, specifically the popular file-and-suspend as well as the practice of filing for a restricted claim for spousal benefits.

Frederick P. Gabriel Jr.

The provision, built into the bipartisan budget plan that also averted a default on U.S. debt, has far-reaching implications for Americans who turn 62 in 2016 or later — and it came out of left field. Even our very own Social Security expert, Mary Beth Franklin, wrote in a column that appeared on InvestmentNews.com last Wednesday that she was "absolutely gobsmacked" by the development.

Gobsmacked or not, that didn't prevent Mary Beth and her colleague in *InvestmentNews'* Washington bureau, Mark Schoeff Jr., from rolling up their sleeves and digging into details about the provision and how it will affect clients. Indeed, we knew advisers were going to get lots of telephone calls from clients about the provision and wanted to make sure they had answers.

WE HAVE THE DETAILS

And we did. The results of our efforts can be found in Mark's Page 1 story as well as Mary Beth's detailed breakdown of the provision on Page 21.

Also on Page 21 you'll find a handy chart — thanks to the expertise and hustle of our Medicare expert, Katy Votava at Goodcare.com — detailing estimated changes to Medicare premiums, also touched on in the provision.

Part of our mission here at *InvestmentNews* is to make sure our readers have the news and information they need to run their practices well and to provide exceptional advice to their clients. In looking over our coverage of the developments surrounding the deal that changed Social Security claiming strategies, I think we hit the mark.

This is a development we'll continue to follow closely.

fgabriel@investmentnews.com; Twitter: @FredPGabriel

Fidelity charged with dishonesty

Firm allowed unregistered RIAs to trade on its platform, Massachusetts says

By Bruce Kelly

Fidelity Brokerage Services was charged in an administrative complaint last Monday with dishonest and unethical behavior by the commonwealth of Massachusetts for allowing unregistered investment advisers to make trades through the Fidelity Investments broker-dealer platform, thereby generating fees for both the firm and the unregistered advisers.

At least 13 unregistered Massachusetts investment advisers used Fidelity's platform, according to a statement from secretary of the commonwealth William Galvin.

'BLATANT' ACTIVITY

For those advisers, "Fidelity served as a haven from regulatory oversight as it ignored blatant unregistered investment advisory activity," according to the statement from Mr. Galvin's office.

"We do not believe that Fidelity has violated any laws or regulations in connection with this matter," said Adam Banker, a Fidelity spokesman. "We look forward to reviewing the details of this matter and addressing them appropriately."

BLOOMBERG

"Fidelity, of all companies, knows full well the range of investor protection provisions resulting from regulatory oversight," Mr. Galvin said in the statement. "For them to knowingly allow unregistered activity on their broker-dealer platform is a profound failure of their regulatory obligations."

In one instance, more than 20 Fidelity customers paid one unregistered investment adviser who was trading on their behalf $732,000 in advisory fees over a 10-year period, according to the complaint.

'HAD KNOWLEDGE'

The complaint alleges that Fidelity had knowledge that the individual was acting as an adviser during that entire period and encouraged his trading activity by providing the purported adviser, who made thousands of trades in the accounts of his clients, with gifts such as frequent flyer miles and tickets to a professional sporting event.

Fidelity had policies in place since 2011 that specified red-flag risk warnings for certain levels of third-party trading, but those were ignored until recently, according to the statement from Mr. Galvin.

bkelly@investmentnews.com
Twitter: @bdnewsguy

Warren attacks annuity sales incentives

Perks distract agents from focusing on what's best for clients: Senator

By Mark Schoeff Jr.

Vacations at luxury resorts, golf outings, tickets to sporting events and other incentives to sales representatives have led to inappropriate sales of annuities, Sen. Elizabeth Warren, D-Mass., claimed in a study released last Tuesday.

NON-CASH INDUCEMENTS

In a survey of 15 firms, Ms. Warren's staff found 13 offered non-cash inducements to their agents to sell their annuities, which guarantee income but often are complicated, are known for having high fees, and can tie up large chunks of a client's money.

Disclosure requirements surrounding the perks are inadequate and usually

Continued on Page 23

"COMPANIES shouldn't be allowed to offer expensive vacations, prizes and other kickbacks ... for selling costly, second-rate investment products."

Sen. Elizabeth Warren, D-Mass.

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CARL RICHARDS

Investing should be exciting only if you think long-term

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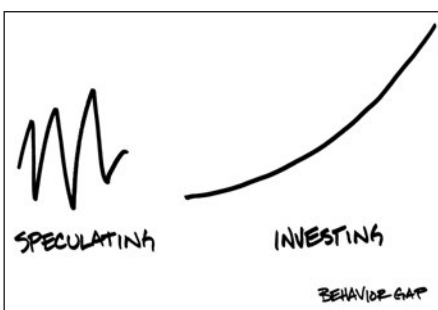

Much of what we hear in the news makes investing look more like a three-ring circus. On top of that, it can be exciting for clients to think they're getting a peek into a super-secret investing world. Why wouldn't you follow the advice of someone who claims to make thousands of dollars trading every day?

But the circus ignores something very important to the individual investor. Much of what we hear and read is about short-term activity. It's entertaining, maybe even exciting. But most of all, it's speculating.

People are placing a bet that what they hear today can return a profit before things change. There's no thought to years, only weeks, maybe months.

With investing, we're asking clients to look far beyond what the circus is talking about today. As I've said many times, it's short-term boring, but long-term exciting. Investing means buying an investment at a certain value and expecting to hold on to it for a long time. That doesn't make for a very good headline.

KEEP IT SIMPLE

When you're talking to clients, don't be afraid to keep it simple. Speculating is about buying an asset and hoping the price will change in the short term. Investing is about buying an asset with value and holding onto it for the long term, believing the value will increase.

The financial media doesn't always make it easy for clients to understand the difference. You can help clients by explaining it to them. And by helping them learn to tune out the noise that doesn't matter, you're helping them reduce their anxiety as investors.

Podcast
To listen to Carl Richards' podcast about this column, go to InvestmentNews.com/richards

Carl Richards is a certified financial planner and director of investor education for the BAM Alliance. He's also author of the weekly "Sketch Guy" column at the New York Times. He published his second book, "The One-Page Financial Plan" (Portfolio) this year. ***Email Carl at mastercomm@behaviorgap.com.***

Voya accused of 'dirtying' the record of rep who left

By Bruce Kelly

A broker-dealer claims a new adviser at his firm had her employment record tarnished by her old employer, Voya Financial Advisors Inc., in revenge for her leaving.

Allegations of "marking up" or "dirtying" brokers' employment histories when they jump to a new firm in order to hurt their job chances and careers are rife in the securities industry, which is highly competitive and relies heavily on firms' recruiting new advisers. However, it is extremely rare for a B-D executive to speak publicly about the practice.

> "A TOP EXECUTIVE at Voya and others were personally trying to get [Ms. Thomas] to stay. When she said no, they dinged her U5."
>
> **David Fischer**
> Managing director
> Independent Financial Group

LEFT FOR IBD

The adviser in question is Joyce Thomas, who resigned from Voya on Oct. 8 to join Independent Financial Group, an independent broker-dealer with 530 registered reps and advisers. Independent Financial had $118.7 million in revenues in 2014.

David Fischer, managing director of Independent Financial, said Voya is playing unfairly with Ms. Thomas' employment history, by placing damaging information on a U5 form filed with the Financial Industry Regulatory Authority Inc.

A form U5 is the securities industry uniform termination notice that is filled with questions asking the reasons why a broker left a firm.

"Voya has amended her U5," said Mr. Fischer. "A top executive at Voya

Continued on Page 23

Fiduciary freeze bill passes House

Measure to force DOL to wait on SEC action goes to Senate; veto looms

By Mark Schoeff Jr.

Legislation that would block a Labor Department proposal to raise investment advice standards for retirement accounts passed the House last Tuesday. But there's a veto threat waiting in the wings.

The bill passed on an almost party-line vote of 245-186, with only three Democrats voting for it and two Republicans voting against it.

The legislation, which was written by Rep. Ann Wagner, R-Mo., would force the DOL to halt its deliberations on a fiduciary rule until the Securities and Exchange Commission acts on a similar requirement for retail investment advice.

"The SEC ought to be acting in this area; that is their primary role,"

GETTY IMAGES

Rep. Ann Wagner: Wrote anti-DOL fiduciary bill that passed the House.

Rep. Ander Crenshaw, R-Fla., said during floor debate. "It's a common-sense piece of legislation."

The bill has drawn a veto threat from the Obama administration, which supports the DOL proposal.

"The administration strongly opposes [the Wagner legislation] because the bill would derail an important Department of Labor rulemaking critical to protecting Americans' hard-earned savings and preserving retirement security," the Office of Management and Budget said in a statement last Monday.

Introduced in April, the DOL rule is designed to reduce conflicts of interest for brokers working with 401(k) and individual retirement accounts. Supporters say the rule would protect investors from high-fee products that erode retirement savings. Opponents assert that it will

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Slide show

10 best financial adviser jokes

"An adviser walks into a bar …" Take a look at our favorite financial adviser jokes.

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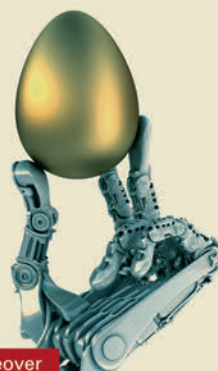
INTV VIDEO Watch this week's clips at InvestmentNews.com/INTV

Practice Makeover

Season 4, Episode 1: To be or not to be a robo-advisory practice

Over the past five years, robo-advisers have taken the financial services industry by storm. Are they a threat to the average adviser, or an opportunity? We invaded a small practice in Raleigh, N.C., to give them a practice makeover — robo-style.



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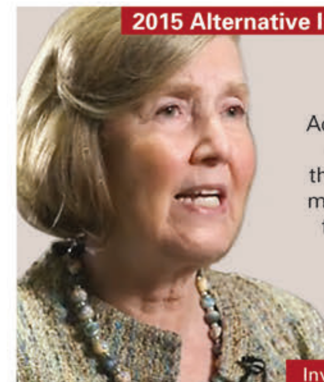
2015 Alternative Investments Conference

How alts can resolve fixed-income dilemma

According to **Dorothy Weaver** of Collins Alternative Funds, the biggest issue on advisers' minds is what to do with their fixed-income portfolios. She explains how long/short credit strategies can help.



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Five firms to reimburse $18M in mutual fund fees

B-Ds failed to waive sales charges or used wrong share classes

By Liz Skinner

Five broker-dealers have been ordered to reimburse clients a total of $18.4 million for charging them improper fees for mutual funds, Finra announced last Tuesday.

Edward Jones was ordered to pay $13.5 million, Stifel Nicolaus & Co., $2.9 million, Janney Montgomery Scott, $1.2 million, Axa Advisors, $600,000 and Stephens Inc., $150,000. The firms neither admitted nor denied the allegations as part of a settlement with the Financial Industry Regulatory Authority Inc.

EARLIER VIOLATIONS

The regulator found that going back to as early as July 2009, the mutual funds that these firms made available through their retail platforms failed to offer some investors — charity and retirement accounts — waivers that they were due for some upfront sales charges on Class A shares. In other instances, the investors were put into the wrong share classes, which subjected them to charges they should not have been assessed.

Three months ago, Finra ordered Wells Fargo Advisors, Raymond James and LPL Financial to pay a combined $30 million for the same type of violations. Wells Fargo later expanded its remediation plan to pay $7 million more to additional accounts, so in all, the eight firms will pay about $55 million to about 75,000 retirement accounts and charities, Finra said.

"These actions are further evidence of our commitment to pursue substantial restitution for adversely affected mutual fund investors who were not afforded the full benefit of available sales charge waivers," Brad Bennett, Finra's executive vice president and enforcement chief, said in a statement.

The five firms included in the announcement also "unreasonably relied on financial advisers to waive charges" for these accounts without training them or providing them with the correct information on how to do so, the industry group said.

Last year, Finra fined Merrill Lynch $8 million, in addition to

Continued on Page 20

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JACKSON® LONG-TERM SMART®

LPL buying back $500M of its shares

By Bruce Kelly

A month after an activist hedge fund took a large stake in the company, LPL Financial Holdings Inc. said last Thursday it had authorized a $500 million buyback of its shares and intends to reduce its rate of expense growth in 2016.

"We are buying back shares because they are cheap," chief executive Mark Casady said. "We are also making clear what our expense growth rate will be in 2016, and that it will be lower than 2015."

LPL's board authorized the share buyback program as part of an updated capital management plan "to create greater shareholder value," the firm said after releasing its third-quarter earnings report.

Activist hedge fund investor Marcato Capital Management recently took a 6.3% equity stake in LPL, due to its view that LPL's shares were undervalued.

NO ONE'S HAPPY

"None of us are happy with the performance" of LPL shares, Mr. Casady said. "There is no light of day between what Marcato and other shareholders want," which is to see LPL's share price increase, he said.

LPL shares closed Friday at $42.60, off 23% from their March 2014 high of $55.37.

LPL posted mixed results for the quarter ended Sept. 30. Its net revenue — $1.05 billion — was down 3.2% when compared with the same period in 2014. Net income of $41.1 million was up 23.4%, compared with the 2014 period.

After its most recent $1.4 million settlement in September, Mr. Casady said that the company was in "good shape" with the regulators.

"The parade has moved on to other broker-dealers," he said. "They are entering the phase we were in two years ago."

LPL has been hit with millions of dollars in regulatory fines over the past several years and has invested in staff and technology as a result.

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MDY's 3 month average daily trading volume was over $438,363,246 notional as of 06/30/2015. The second most liquid mid cap ETF traded an average notional value of $154,893,062. Assets for MDY as of 06/30/2015 were $16B. Source: Bloomberg.

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VIEWPOINT

EDITORIALS

The next few years are going to hurt

SOME ECONOMISTS are predicting an era of slow growth for the foreseeable future, and if they are correct, that would have significant implications for investors.

Last week, the Commerce Department's preliminary estimate of the rate of increase in the gross domestic product in the third quarter was 1.5%. That was down dramatically from the 3.9% rate in the second quarter, but substantially higher than some predictions by economists, such as Goldman Sachs' estimate of a 1% increase and the Atlanta Federal Reserve Bank's call for only a 0.9% increase.

They are concerned about the economic slowdown in China, one of the biggest customers for U.S. exports of goods and services, and about Japan's and Europe's weak economies. They also are concerned about weak investment by U.S. companies and slow productivity growth.

Slow population growth also is considered a contributor to slow economic growth, and the U.S. replacement rate (number of births per woman) dropped to 1.88 in 2012 from 3.65 in 1960. In China it has dropped to 1.66 and in Japan to 1.41 in the same period, suggesting long-term growth problems.

The real GDP growth rate in the U.S. has been below par since 2011, when it was 1.6%. It was only 2.3% in 2012, 2.2% in 2013 and 2.4% in 2014. It did not top 2.4% until the second quarter of this year, when it shot up to 3.9% after registering only 0.6% in the first quarter.

The average growth rate since 1948 has been 3.23% per year. Many economists expect the economy to struggle to top 2.5% a year for the next few years, especially if the Federal Reserve raises interest rates bit by bit over those years. Rising rates generally serve to slow the rate of economic growth.

Slow economic growth would hit investors in multiple ways. It means low stock market growth because corporate earnings, and hence stock prices, can't grow faster than the economy. It also means low interest rates. Both would be bad for retirees and those trying to accumulate assets for retirement.

For retirees, low rates and low equity returns increase the danger of outliving their resources, unless they reduce their lifestyles. In addition, slow growth likely would mean low inflation, and that in turn would mean no increase in Social Security. As we saw this year, Medicare contributions could increase.

For workers, low equity returns would make it much harder to accumulate the retirement nest eggs they eventually will need.

> **LOW RATES** and low equity returns increase the danger of outliving one's money.

What can advisers do? They must watch the trend in the GDP growth rate and prepare their clients for the possibility of slow growth. Talk to clients and prepare alternative financial or investment strategies.

TEMPER EXPECTATIONS

If advisers see the rate of GDP growth remain low — below the historic 3.23% rate — the first step should be to lower client expectations about investment returns.

The next step would be to encourage retiree clients to reduce their lifestyles if possible. Discretionary spending should be cut back until economic growth improves, and with it, expected investment returns.

Working clients should be encouraged to increase their savings rate. What investment returns are unlikely to produce, savings must provide if a comfortable retirement, or other financial goal, is to be achieved. However, it will be difficult to increase the savings rate with pay increases expected to be small, as they have been for the past five years.

For clients of an appropriate age — those with many years before retirement — advisers might suggest more risk taking to perhaps earn higher returns. Higher-risk investments do not always result in higher returns than lower-risk portfolios, but over the long run, they usually do.

Long-term slow economic growth is not inevitable, but faster growth will depend not only on smart economic management in this country, but also in the nation's major trading partners so they too break out of their slumps.

It is only prudent that advisers and their clients prepare to adapt their financial and investing plans in case the slow growth continues for more than a year or two.

Ready to plan till age 110?

When you think about retirement in terms of being unemployed, the whole venture sounds a little scary. If you think about it as 35 years of unemployment, it's downright frightening.

But *InvestmentNews* reporter Liz Skinner suggested doing just that in a recent story that featured new data added to the Society of Actuaries' predictions about how long pension plan participants will live.

That organization uses conservative figures from the Social Security Administration, which finds a woman born in 2011 can expect to live to about age 81, while a man can expect to reach 76. That doesn't sound so far off base, right? Until you look closer.

The longer people live, the higher the odds are that they will keep living. So once a woman hits 81, she can expect to live another nine years. A man who makes it to 76 has a good 10 years ahead of him, on average.

Average is a key word. Wealthy people tend to live longer than the average.

POTENTIAL BREAKTHROUGHS

Also, some aging experts make predictions based on yet undiscovered but likely medical breakthroughs, or those just on the cusp that aren't in wide circulation yet (think drugs that target cancer cells, for one). Life estimates then expand dramatically. Ms. Skinner pointed out that some researchers say those born in the most recent decade are likely to face life as supercentenarians — living to 110 or older.

In these cases, does running what are traditionally considered conservative 30-year models for testing a portfolio's survival through retirement become outdated?

ADD YOUR VOICE to the mix. Readers: Keep letters brief. Include your name, title, company, address and a telephone number for verification purposes. Email Frederick P. Gabriel Jr. at fgabriel@investmentnews.com. All mail may be edited.

Surely people will adjust over time to longer lives by working longer and hopefully saving more. And your clients currently in retirement probably won't experience the full benefits of the medical miracles ahead, so living into their 100s won't be common.

But it's not far off.

And we can learn from those who do make it to advanced ages today. A recent New York Life study of people 80 and older offers an insightful fact: More than half of the octogenarians surveyed said that when they were planning retirement many moons ago, they never expected to live to the ages they've attained. It's the adviser's job to make sure they do expect it — and plan for it.

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VP-Publisher: Suzanne Siracuse ssiracuse@crain.com

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Editors:
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ADVERTISING
National Sales Director: Mary Meagher mmeagher@crain.com 212-210-0115
Regional Sales Managers:
New York:
Nicole Casement ncasement@crain.com 212-210-0167
Kevin Reardon kreardon@crain.com 212-210-0476
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San Francisco:
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Boston:
John Bubello Jbubello@crain.com 978-534-5635
Reprint Manager: Laura Picariello 732-723-0569 lpicariello@crain.com
Inside Account Manager: Letitia Y. Buchan lbuchan@crain.com 212-210-0451

MARKETING AND AUDIENCE DEVELOPMENT
Audience Development Director: George Ortiz gortiz@crain.com
Senior Marketing Manager: Diana Cheruvil dcheruvil@crain.com
Creative Marketing Manager: Lorenzo John ljohn@crain.com
Marketing Associate: Shannon Rosic srosic@crain.com
Digital Marketing Coordinator: Shannon Murphy smurphy@crain.com
Executive Assistant to the Publisher: Irma Rodriguez irodriguez@investmentnews.com 212-210-0430

PRODUCTION
Prepress/Production Director: Simone Pryce

INVESTMENTNEWS OFFICES
Headquarters: 685 Third Avenue, New York, NY 10017-4024
Editorial fax: 212-210-0444
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Washington: 814 National Press Bldg., Washington, DC 20045, Fax: 202-638-3155
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Weigh the alternatives before you put clients in alternatives

By Greg Iacurci

Advisers should look beyond a one-size-fits-all approach for clients when it comes to investing in alternatives.

Rather, they should have a conversation about what a client is seeking from an alternative investment, as well as the client's capacity for risk and liquidity needs, before deciding how to invest in such a strategy, according to executives who spoke last Tuesday at the fifth annual *InvestmentNews* Alternative Investments Conference in Miami.

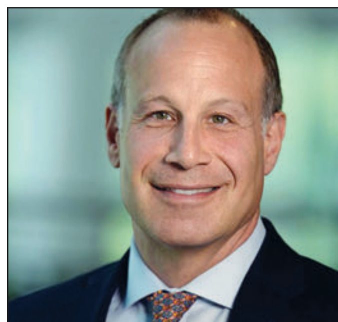
The decision regarding where to invest in alts, and whether it's through a liquid mutual fund vehicle or something more illiquid, begins with the question of why a client is investing in alts, said Ben Rotenberg, portfolio manager at Principal Management Corp.

For example, if a client seeks return but not as much liquidity, private equity may make the most sense, while if a client wants liquidity and low volatility, a liquid alts mutual fund-of-funds is more appropriate, Mr. Rotenberg said.

DUE DILIGENCE

"Not every hedge fund strategy is liquid. As an adviser, if you're putting your clients in liquid alts, one of the things you need to do is due diligence on what types of strategies are in these products," said David Katz, president and chief operating officer at Larch Lane Advisors.

Certain strategies that use commodities, currencies, stocks and bonds are more liquid, for example,



"THE REALITY is, having daily liquidity cuts you out from certain [alternative] strategies."

David Katz
President and COO
Larch Lane Advisors

but some with other kinds of holdings could be much less liquid, he said. "The reality is, having daily liquidity cuts you out from certain [alternative] strategies," Mr. Katz said.

Some alternative strategies work well within '40 Act investment vehicles while others don't, and many managers have been trying to decide which vehicles lend themselves most naturally to their offering, according to John Grady, chief strategy and risk officer at RCS Capital Corp.

For example, a strategy that uses high leverage likely wouldn't be suited to a '40 Act vehicle, because there are leverage constraints related to such vehicles, he added.

"We're seeing a lot of strategies starting to pick and choose," Mr. Grady said, equating it to "speed dating."

There's been a push across the asset management industry to make inherently illiquid strategies into more-liquid structures, but that could water down the nature of the returns on a particular strategy, or fundamentally change the way managers go about achieving returns, according to Walter Davis, alternative investment strategist from Invesco.

"I think a lot of it comes down to the provider being familiar with the needs of the retail investor," Mr. Davis said.

Long-short funds, for example, don't typically require much tweaking to go from a typical hedge fund to a more liquid vehicle, whereas that would be much more difficult with something like a distressed-credit hedge fund, Mr. Rotenberg said.

giacurci@investmentnews.com
Twitter: @gregiacurci

"YOU CANNOT INVEST in one future anymore; you have to invest in multiple futures."

Bob Rice
Chief investment strategist
Tangent Capital

LORENZO JOHN

60/40 portfolios are hopelessly 'broken'

Tangent's Rice: They don't work anymore

By Jeff Benjamin

The standard setup for an investment portfolio has too many risks, not the least of which is an expected annual return of 2.2% for a portfolio of 60% stocks and 40% bonds, according to Bob Rice, chief investment strategist at Tangent Capital.

Speaking last Tuesday in Miami at the fifth annual *InvestmentNews* Alternative Investments Conference, Mr. Rice painted a gloomy outlook for investment strategies that are following traditional paths based on traditional models.

"The things that drove 60/40 portfolios to work are broken," he said, citing lofty stock market valuations, unprecedented monetary policies, swelling risks in bond funds, falling commodity prices and the influence of technology that is disrupting industries and economies radically.

"You cannot invest in one future anymore; you have to invest in multiple futures," Mr. Rice said.

For an example of how some of the largest institutional investors are viewing the investment landscape, Mr. Rice pointed out that Yale University's endowment currently has a 6% allocation to stocks and a 5% allocation to bonds.

"That's an all-time low [allocated to traditional investments] for Yale," he said. "The reason is there are fundamental changes in our economy and the global structure that have fundamentally altered the nature of investing."

NEW PATH TO GOALS

With the foundation laid, Mr. Rice emphasized the use of alternative strategies to achieve many of the goals that historically have been accomplished through allocations to stocks and bonds.

While growth and inflation protection have long been achieved through basic allocations to stocks, the new model includes alternative investments such as private equity, venture capital, activist investing, gold, timber and collectibles, in addition to stocks.

For income and downside protection, which traditionally have been achieved through allocations to bonds, Mr. Rice said financial advisers should be also looking at areas such as master limited partnerships, royalties, emerging-markets debt, long-short equity and long-short credit.

"The old 60/40 portfolio did the things that clients wanted, but those two asset classes alone cannot provide that anymore," he said. "It was convenient, it was easy, and it's over. We don't trust stocks and bonds completely to do the job of providing income, growth, inflation protection and downside protection anymore."

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The revolutionary change in industry is about behavior

Keep clients on the straight and narrow in their financial life

It's hard to see revolutions while living through them. Changes occur gradually, almost imperceptibly, until one day you step back and realize that the world has become all so very different.

The most obvious change to financial advice has been the unbundling of services to permit lower-cost shopping. Once wrapped irretrievably into brokerage commissions, stock and fund advice now can be purchased in multiple ways. It may be bought through asset-based fees, flat fees, or at a discount price via robo-advisers that communicate with their customers through the telephone and Internet. Or it may be dispensed with altogether, for investors who seek only their own counsel. This new flexibility is a clear investor benefit. There is more choice, an option to pay significantly less, and greater transparency.

MOTIVATION

But while unbundling has attracted attention, there has been another, quieter evolution that has been less discussed: the move from treating financial advice as "selecting the best security" to "motivating the best behavior."

Not, I hasten to add, that there's anything wrong with owning excellent securities. After all, I am employed by Morningstar Inc. But Morningstar's traditional business of security-versus-security comparisons covers only one aspect of achieving financial success and is far from a sufficient cause. Investors who have bad investment habits, ranging from spending too much to saving too little, will generally fare poorly even if their securities are good.

> **GAMMA** consists of anything that improves an investor's outcome ... the beauty ... is that it is achievable.

The trend to motivating better behavior extends across all advice channels.

With full-service advice, financial professionals are becoming more holistic. Rather than defining their value as primarily coming from recommending funds or stocks that the investor could not find without assistance, they instead are positioning themselves as the financial equivalent of personal trainers. Successful personal trainers, by and large, do not possess fitness secrets. Their business consists of telling their clients what is publicly known and then ensuring that the actions are taken. Their value lies not in the ideas, but rather in the execution.

(Of course, financial advice is more complicated than personal training. It's only an analogy, my financial-adviser friends.)

Morningstar's David Blanchett and Paul Kaplan use the term "gamma" to describe what advisers can do for their retired clients beyond the alpha of security selection and the beta of asset allocation. In a typical retirement situation, they argue, an investor can pick up another 1.6 percentage points per year in return through 1) correct asset location (for tax purposes); 2) asset allocation that considers the investor's total wealth in addition to risk capacity; 3) the appropriate use of annuities; 4) dynamic withdrawal strategies that adjust to market changes; and 5) taking liabilities into consideration when doing asset allocation.

HOW TO IMPROVE OUTCOMES

Politely — as it is their term and not mine — I would suggest extending the concept of gamma beyond investment techniques. For me, gamma consists of anything that improves an investor's outcome besides what people normally think of as the job of financial advice: that is, asset allocation and security selection. The beauty of gamma is that it is achievable. It's hard for financial advisers to deliver new betas to their clients, or to find alpha. But cutting tax bills, incorporating better withdrawal strategies, improving savings behavior, developing a strategic rather than tactical mindset ... these are things an adviser can do, and do well. So, too, can other advice mechanisms.

Within 401(k)s, computerized advice began with the old school of alphas and betas. The online-advice providers of the new era, of which Morningstar was one, competed for business almost solely along those lines, by pitching corporate treasury departments about the sophistication of their investment models. Each provider claimed to have the best forecasts and, thus, the best recommendations. Such discussions were largely beside the point. High 401(k) balances result from high contribution rates, made for many years, and invested in diversified, low-cost portfolios. Further details are mostly rounding errors.

Senior loans are typically lower-rated and may be illiquid investments (which may not have a ready market). **Class Y shares are not available to all investors. Please consult your financial advisor to determine if you are eligible to purchase.**

ISTOCK PHOTOCOMPOSITE

Happily, today's employers know now what they did not know then. As a group, they no longer worry so much about investment wizardry, focusing instead on the basics. Employers have pushed hard on 401(k) costs, driving down fund fees and record-keeping expenses. They have adopted automatic enrollment and, increasingly, auto-savings programs that push employees into making greater contributions. And for the most part, they are fine with defaulting into target date funds. Why fuss over the nickels of the investment details when there are dollars to be made by improving investor behavior?

STEP FORWARD

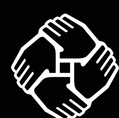
Robo-advisers also represent a step forward. True, they exaggerate the specialness of their investment recommendations, which are sensible rather than remarkable, but they are less guilty of that sin than were their 401(k) online advice predecessors.

They also don't whiz and bang in the fashion of the 1990s offerings from the big Wall Street brokers. The central promise of robo-advisers is modest: a diversified, low-cost portfolio that gives some useful tax advice. Those items are much easier to achieve than generating alpha, but they are not necessarily less useful.

None of this should be read as implying that all financial advice is trustworthy, reliable and worth the price it demands. That has never been true.

As a lucrative industry with low entrance standards, financial advice has been and will be a refuge for ambitious frauds. But the direction is encouraging. The movement away from promising investment magic, and toward discussing better investment habits, can only lead to better investment outcomes.

John Rekenthaler is a columnist for Morningstar.com and a member of Morningstar's investment research department.



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Ponzi artist's adviser gets 2½-year term

Szafranski's sentencing is the most recent tied to $1.2B Florida fraud

By Alessandra Malito

Five years after a South Florida lawyer went to prison for running a $1.2 billion Ponzi scheme, his financial adviser faced his own reckoning.

In 2010, Scott Rothstein, an attorney with Rothstein Rosenfeldt Adler in Fort Lauderdale, was sentenced to 50 years in prison for wire fraud, money laundering and racketeering. His financial adviser, Michael Szafranski, was given a 2½-year prison sentence last Monday after pleading guilty to wire fraud.

Mr. Szafranski is the latest of more than two dozen people who have been convicted in connection with the Ponzi scheme. According to local news sources, he paid restitution of $6.5 million five years ago to the victims through the trustee handling the bankruptcy of Mr. Rothstein's law firm.

Mr. Szafranski's lawyer did not respond to a request for comment.

NO LONGER IN BUSINESS

Mr. Szafranski's Form ADV shows he has not been a registered investment adviser since 2010. The Financial Industry Regulatory Authority Inc.'s BrokerCheck shows he received a final regulatory notice in 2008 for failing to file his Form ADVs for 2004, 2005 and 2006.

Mr. Rothstein was accused of selling discounted stakes in fake settlements of sexual-harassment and whistleblower lawsuits, according to a 2010 Bloomberg article. He allegedly created fake settlement papers, bank statements and personal guarantees with co-conspirators.

Also involved in the case was a TD Bank regional vice president, Frank Spinosa, who pleaded guilty earlier this year. The SEC charged he made a "series of material misstatements and omissions to investors to continue the fraudulent scheme."

amalito@investmentnews.com
Twitter: @malito_ali

NAPFA claims 'moral high ground' in DOL fight

Outspent, outgunned, fee-only adviser group will step up lobbying

By Mark Schoeff Jr.

Fee-only investment advisers who support a pending Labor Department advice rule say they will step up their lobbying in order to project their voices amid the din of industry opposition.

"We are outspent and outgunned, but we have the moral high ground," Dave O'Brien, founder of O'Brien Financial Planning Inc. and a member of the National Association of Personal Financial Advisors' public policy committee, said in a session at the group's fall conference in Indianapolis on Oct. 23.

The organization's members are confident they have the right message. They argue that the proposal, which is designed to reduce conflicts of interest in advice to 401(k) and individual retirement accounts, would protect investors from high-fee products that erode retirement savings.

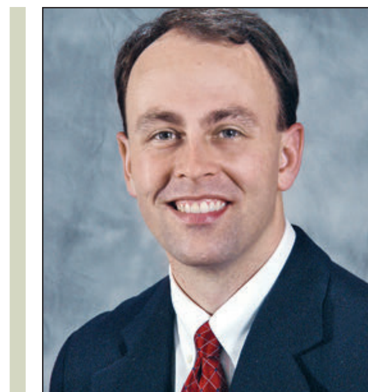
But the National Association of Insurance and Financial Advisors said NAPFA and other rule backers support the regulation because it favors the fee-only advice model. They say it puts brokerage-based advisers at a disadvantage by significantly raising their liability risk and regulatory costs.

"NAIFA certainly does not concede the 'moral high ground' in the debate over the DOL proposal," NAIFA president Jules Gaudreau said in a statement. "In fact, some of the most vocal proponents of the DOL proposal seem to be looking out for their own interests. They have put a lot of effort into supporting new regulations on advisers who they see as their competition."

AVOIDING CONFLICTS

The rule resonates with NAPFA members, who believe their fee-only approach to advice allows them to avoid conflicts of interest. NAPFA members also must be certified financial planners, who already are required to place their clients' interests ahead of their own.

"NAIFA has always said there is absolutely a place for fee-only advisers," Mr. Gaudreau said. "However, we do not believe in a one-size-fits-all approach."



"WE DON'T have a lot of money to throw at this, but we do have ideas."

John Gugle
Principal
Alpha Financial Advisors

Fierce lobbying against the DOL proposal is leaving NAPFA and its allies in the dust.

Mr. O'Brien played a television commercial produced by opponents of the rule, including NAIFA, that depicts a construction company manager asserting that the measure would make it impossible for him to offer a retirement plan to his workers.

"That's what's happening when you have expenditures on lobbying like this," Mr. O'Brien said.

The latest figures on lobbying bear out Mr. O'Brien's analysis on spending. Groups that oppose the DOL rule are investing much more than those supporting it.

WALLETS OPEN WIDE

NAIFA has spent $1.9 million on lobbying this year through Sept. 30, according to filings with the Office of the House Clerk. Two other groups that oppose the rule likewise have opened their wallets wide: The Securities Industry and Financial Markets Association, whose membership includes wirehouses, has spent $5.3 million and the Financial Services Institute, which represents independent broker-dealers, has spent $643,828. The expenditures are directed toward other issues in addition to the DOL rule.

The umbrella group that includes NAPFA, the Financial Planning Coalition, has spent $30,000 so far this year on lobbying. In addition to NAPFA, the coalition includes the Financial Planning Association and the Certified Financial Planner Board of Standards Inc.

As FPA is already doing, NAPFA plans to conduct its own lobbying outside of the coalition in 2016, according to NAPFA leaders.

The effort will include the first NAPFA Capitol Hill day, in which NAPFA members visit Washington to lobby lawmakers.

"There's an appetite within the membership for it," said NAPFA chief executive Geoffrey Brown.

At the NAPFA conference, leaders of the public policy committee said they hope policy arguments can overcome the size disadvantage they face in going up against industry groups.

"We don't have a lot of money to throw at this, but we do have ideas," said John Gugle, principal at Alpha Financial Advisors and a member of the committee.

mschoeff@investmentnews.com
Twitter: @markschoeff

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Compliance merger creates 'bench strength'

By Mark Schoeff Jr.

Two major compliance services for advisers announced a merger last Tuesday, citing increased demand among investment advisers and brokers for compliance help.

National Compliance Services Inc. and Regulatory Compliance say their product lines complement one another, and that the merger will offer advisers one-stop shopping as more advisers become independent and regulations proliferate.

"This positions us to offer the broadest set of compliance solutions and the deepest bench strength of expertise of any single provider," Regulatory Compliance chief executive Stephan Sussman said in a statement.

Both companies are privately held and have been in business for more than 20 years. NCS specializes in compliance consulting for registered investment advisers and broker-dealers, providing registration services and technological support. In addition to registration help, Regulatory Compliance supports financial operations and can serve as an outsourced chief compliance officer.

OUTSOURCING CCO JOB

Many small to medium-size advisory firms face SEC and state mandates to have chief compliance officers, and filling that role can require one person to perform several duties. Rita Dew, NCS president and chief executive, said the combined firm can help advisers with these duties, or advisers could do a complete outsourcing of those functions to the firm.

The merger of the firms will reduce competition in the compliance-consulting market but not necessarily raise costs, Ms. Dew said.

"If anything, we think it might lower prices," she said. The merger "gives us greater expertise and more people to be more flexible in our pricing model."

No decision has been made on the headquarters for the merged firm. NCS will continue to operate from its Delray Beach, Fla., headquarters, while Regulatory Compliance has offices in New York, Boston and southern New Hampshire. The new company will have five offices nationwide, and Mr. Sussman and Ms. Dew will serve as co-chief executives.

The companies declined to provide financial details about the merger, which became effective Sept. 16. But they promised they would expand their services.

Mr. Sussman said they anticipate more consolidation in the industry, and plan to "design and deliver support we know clients will value, including tax services, cyber-assessments and legal support."

mschoeff@investmentnews.com
Twitter: @markschoeff

PRACTICE MANAGEMENT

Joni Youngwirth

Have founderitis? Learn to let go

It's hard, but you have to let your successor make decisions and move into the leadership role

The average age of advisers is well into the 50s, leading to an industrywide search for the next generation of advisers who will lead the firms of the future. Finding the right next-gen adviser is just part of the challenge. For those of you who are tenured advisers, it means learning to let go while helping your successor step into a leadership role.

As you may know, this transition isn't always seamless. You may, in fact, be experiencing founder's syndrome (aka "founderitis"): You've built your organization from its creation to its existing state, and now you can't let go. Sound familiar?

SHARE THE WISDOM

Why shouldn't it be hard to let go of something you've probably spent years building? After all, just think of the wisdom you've gained over the course of your career. You have:

• Brought on each new client, building strong relationships over the years.

• Experienced every market turn over decades and worried about how your business would survive (more than a few times).

• Witnessed vast changes in technology — the ones that didn't work and the ones that revolutionized this industry.

• Observed some employees make positive improvements to your firm — and watched others go because it just wasn't a good fit.

• Made decisions ranging from moving or modernizing your office space, to determining the most appropriate fee structure for the services you provide.

'FOMO' can be used to describe advisers who are addicted to their practices.

Wouldn't it be terrible to waste that wisdom? Remember, to the next-gen adviser, you know it all. If you let founderitis interfere — calling all the shots, making all the decisions, and/or shooting down new ideas — you risk losing the individual you've chosen to be your firm's next leader. How can you avoid this "crash-and-burn" scenario? Let's examine some simple ways to ease this transition.

TWO PERSPECTIVES

As a founder, your wisdom is valid. But exhibiting too much (or too little) control can be harmful. Both founders and next-gens should be aware of each other's perspective.

Attitude: The business is not your baby. Granted, you have created and nurtured your firm to reach its current level. But if you want your business to continue to prosper, you must treat it as a legitimate business. This includes ensuring that there is solid, long-term leadership in place.

Decision making: Are you still making all the decisions three to five years into your transition? This is a red flag for founderitis. Even if you don't expect to exit for a decade, the transition in decision making is something that should evolve over time.

Teaching moments: As you start exiting your practice, step back and observe how the next-gen adviser handles specific situations and offer guidance when needed.

Beta testing: Create "beta tests" in which you're not available for stretches of time (a week, and then perhaps a month at a time), and communicate to your staff that the next-gen adviser will be making decisions during your absence. Otherwise, the clients' strong loyalty to you can interfere with the transition.

For archived columns, go to InvestmentNews.com/practicemanagement

Vision and values: Making the vision and values of your firm crystal clear is the most fundamental component of a successful transition — and the most easily overlooked. When you take the time to instill your values in your successor, it increases the chances his or her thinking will reflect similar values.

ADDICTED TO WORK

"FOMO" (or fear of missing out) is the acronym used to describe people so addicted to social media that they must constantly check Facebook and Twitter. It also can be used to describe advisers who are addicted to their practices. FOMO creates anxiety in the founder who hasn't figured out how to replace the benefits he or she gets from work with something else.

Whether those benefits include a feeling of status, a sense of purpose or having the structure of going to the office, if you can let go of being the sole voice of your firm, you will have a more sustainable legacy.

Joni Youngwirth is managing principal of practice management at Commonwealth Financial Network.

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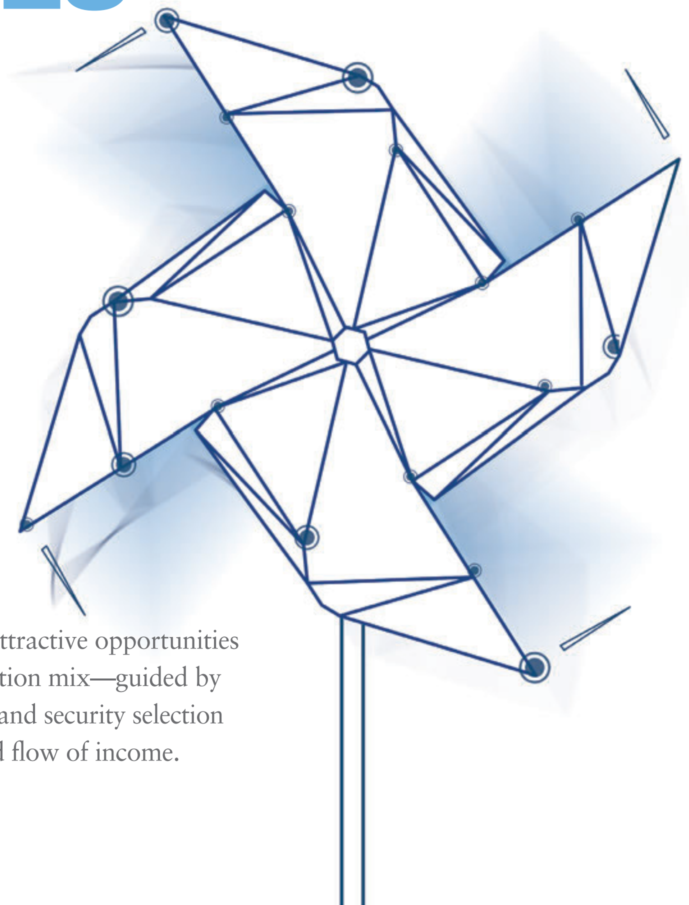

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THE TAX-CONSCIOUS ADVISER
Tim Steffen

Help lessen the impact of the AMT

High-earning clients likely to be caught up in the tax code's confusing alternate universe

Any successful investment adviser understands that it's not about the return you earn; it's about the return you keep. Advisers need to manage a portfolio by keeping one eye on the market and the other eye on the tax man, with the goal of earning the maximum after-tax return possible, given a client's risk tolerance. As a result, successful advisers have learned the basic — and even some of the advanced — rules of the tax code. But one that continually frustrates advisers is the alternative minimum tax.

EXTREME CASES

The AMT was originally created in 1970 after the Treasury announced that 155 high-income individuals had managed to pay no income tax. The Tax Policy Center estimates that 4.5 million taxpayers will owe AMT in 2015, a projection that dropped significantly after the 2012 tax reform act introduced inflation adjustments to slow the growth of the tax. Taxpayers and their CPAs spend countless hours planning around this tax, and advisers should be part of those discussions as well.

The best way to describe the AMT is to think of it as an entirely separate set of rules with its own dictates on what's taxable, what's deductible and how the tax is calculated. After you figure your tax liability under this "alternative" system, you compare it to the tax calculated under the "regular" system, and then you pay the greater of the two. On top of that, you still have to pay any other taxes, such as self-employment tax or the Medicare tax on investment income.

For archived columns, go to InvestmentNews.com/taxconsciousadviser

The AMT tax rate is 26% on AMT taxable income up to $185,400 (for 2015), and 28% over that, with either a 15% or 20% rate on long-term capital gains. Those rates are generally lower than the ordinary tax rate for people at those same income levels. However, the tax under AMT can be larger because the rates are applied to a larger base of income, thanks to the AMT adjustments.

Knowing those adjustments can help advisers and their clients manage the effect of AMT. For example, while interest from municipal bonds is generally tax-exempt, that's not true for AMT. Bonds classified as private-activity bonds pay interest that is taxable for AMT. These bonds tend to pay a higher interest rate than other municipals, but knowing a client's tax situation can help you determine if these bonds are right for them. No adviser wants to recommend to a client bonds that are tax-exempt, only to later have an uncomfortable conversation about why those bonds led to a larger AMT liability.

MISCELLANEOUS DEDUCTIONS

Similarly, investment advisory fees fall into a category of expenses called miscellaneous itemized deductions. While these expenses are deductible for regular tax if they exceed 2% of adjusted gross income, they aren't deductible under AMT under any circumstances. It's good to know your client's tax situation before touting the tax deductibility of your fees.

THE BEST way to describe AMT is to think of it as an entirely separate set of rules.

AMT isn't necessarily always a bad thing. Because the top AMT rate is just 28%, taxpayers sometimes find their marginal tax rate under AMT is less than that under the regular tax, which can be as high as 39.6%. That can create opportunities for IRA withdrawals or short-term capital gains at rates lower than those who escape AMT. The nuances of the AMT calculation are such that it's always best to do a "with" and "without" calculation before deciding to recognize that extra income.

In some cases, additional tax paid due to AMT can be used as a tax credit in future years. Advisers can help clients accelerate the recovery of those credits, rather than giving those tax dollars to the government.

It's very difficult to make generalizations about what income levels are subject to AMT, as there are so many variables at play. For example, because state income and property taxes aren't deductible for AMT, those in higher tax states are more likely to pay AMT, as are those who claim more dependents. Good financial advisers will work with their client's tax adviser and do their part to avoid, or at least manage, the impact of this tax.

Tim Steffen is director of financial planning for Robert W. Baird & Co. Follow him on Twitter @TimSteffenCPA.

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PLANNING FOR COLLEGE
Troy Onink

What college aid strategy is best?

The decision about whether to sell appreciated stocks in taxable accounts is tricky and important

Your clients' 2015 income will be used to determine their children's need-based college aid eligibility for the next two academic years, making the decision about whether to sell appreciated stocks in taxable accounts even more tricky and important.

Another consideration is whether you think the market is poised for a decline from the current highs that would erode the value of those investments, if your clients choose not to sell.

Under current FAFSA rules, students filing for financial aid for the 2016-17 academic year will use their parents' 2016 tax returns, reflecting 2015 income, same as always.

Under new FAFSA rules that go into effect for the 2017-18 academic year, students will use the same 2016 tax return, again reflecting 2015 income. That's because the new FAFSA rules will require that students use tax forms from the prior year instead of the current year, reflecting income from two years prior, not one year prior.

TAXABLE DISTRIBUTIONS

Many mutual funds are set to make large taxable distributions to shareholders in 2015. While many investors in recent years saw their taxable account values climb but were not required to take taxable distributions, this year will be a different story.

Your investment income and the investment itself count against college aid eligibility.

The unearned income (interest, dividends and capital gains) that shows up on a student's or parents' tax returns for 2015, either from selling an investment or from distributions from a mutual fund, will therefore get counted on the student's financial aid forms for the 2016-17 and 2017-18 academic years.

The asset value itself will get counted on the aid forms, too, while it is sitting in a brokerage account or in cash or savings after the sale of the investment.

Depending on the aid formulas used by the colleges, the value of reportable assets in parents' names will be assessed at up to 5% to 5.64%, and in students' names at 20% (most public universities and some private), 25% (at 200 private colleges and UNC Chapel Hill, Georgia Institute of Technology, University of Virginia, William & Mary and University of Michigan at Ann Arbor) and only 5% (at 23 private colleges called the 568 Presidents' Group).

UNREALIZED GAINS

For example, if your client has an investment worth $50,000 that has an unrealized gain of $15,000, just the value of that investment gets reported on the aid forms. As soon as it is sold and the $15,000 gain is realized for tax purposes, then the capital gain income will be reported as part of the parent's adjusted gross income on the aid forms, the FAFSA and CSS Profile.

Assuming your client is in the 25% tax bracket or above (the capital gains tax rate is zero in the 10% and 15% brackets), you will pay capital gains tax at 15% to 20% (as high as 23.8% for some taxpayers), or $2,250 to $3,000 on the $15,000 gain, and raise the child's expected family contribution by about half of the after-tax income, or $6,500.

So how to decide what strategy is best for your client?

If the client's child owns the asset and has no other income, the child will be subject to the kiddie tax and pay $2,100 in capital gains tax. The student's income protection allowance in the aid formulas would offset about $6,400 of the $15,000 in capital gain income. So, after taxes and the student's income allowance — a combined $8,500 — the income from the sale would increase the student's expected family contribution by about $3,250.

For archived columns, go to InvestmentNews.com/planningforcollege

If the child does not qualify for need-based college aid, then sell the asset and focus on the most tax-efficient way to deal with the capital gain income.

AID ELIGIBILITY

If the child is a high school senior enrolling next year or a student already enrolled in college and does qualify for need-based aid, then selling the asset will impact the child's aid eligibility for the upcoming two years, but not subsequent years. If the child is a college junior, the client could wait until January 2016 and then sell, because the resulting income would be in the 2016 tax year, which would only get reported on financial aid forms when applying for aid for the 2018-19 academic year and their child (presumably) already will have graduated.

Troy Onink is the chief executive of Stratagee.com, where he leads the new College InSource Partner Program.

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Expensive ETF is a favorite of advisers

Bloomberg News

Out of more than 500 exchange-traded funds launched in the past three years, the one that has taken in the most cash charges an annual fee of 0.94%.

Wait, what?

That's not a typo.

The First Trust Dorsey Wright Focus 5 ETF (FV) has accumulated $4.2 billion in assets in a little more than a year and a half, taking in money every month. That's despite having a fee that is far higher than even the asset-weighted average mutual fund fee of 0.66%.

FV's success flies in the face of conventional wisdom that ETF investors sniff out only the cheapest products while rejecting the expensive ones. After all, while the average ETF fee is 0.61%, the average asset-weighted ETF fee is just 0.30%.

So why are they flocking to FV?

One word: convenience. FV has essentially ETF-ized a popular sector rotation strategy from Dorsey Wright & Associates, an investment firm with long expertise in technical analysis. Sector rotation strategies aim to ride the coattails of hot sectors. FV's strategy is to select five of First Trust's sector and industry index ETFs based on their relative price momentum and to weight them equally.

CONVENIENCE

Many advisers were already following Dorsey Wright's sector rotation model — they had corporate subscriptions to Dorsey Wright's guided model portfolios — but apparently like the convenience of an ETF that does the work for them.

FV allows advisers to offer aggressive clients its sector rotation strategy in a tax-efficient, rules-based index ETF. The appeal of this to advisers explains the steady flows into the ETF. Advisers tend to invest money on a regular basis, despite market conditions, while institutional investors tend to jump in and out of ETFs, depending on what's hot.

0.94% What FV charges. Average asset-weighted ETF fee is 0.30%.

Why is the ETF so pricey? Because those underlying sector ETFs are pricey. The total cost of the five sibling funds that FV holds is 0.65%. (The rest of the fees go toward paying for licensing the strategy, fund operations and profit for First Trust.)

RETURNS

FV is up 2.7% this year, topping the S&P 500, which is flat. Since inception, however, FV is up 13% compared with the S&P 500's 20% gain. Currently, FV holds ETFs for biotech, health care, Internet, consumer staples and consumer discretionary.

FV isn't alone in being a pricey but successful ETF. There are 20 ETFs that have more than a billion in assets and charge a fee above the 0.66% average mutual fund fee. They include iShares MSCI Emerging Market ETF (EEM), which charges 0.67%, and the PureFunds ISE Cyber Security ETF (HACK), which charges 0.75%. Add up the fees collected by these 20 ETFs, and you get about $520 million a year. That's more than the revenue brought in by all 68 of Vanguard's ETFs combined, and those ETFs have six times more assets.

Even so, advisers place a high value on convenience, something Tom Dorsey, founder of Dorsey Wright, is well aware of. He likes to quote legendary Harvard Business School professor Theodore Levitt, who once said, "People don't want to buy a quarter-inch drill. They want to buy a quarter-inch hole."

And they're willing to pay a premium price for it. The fund's prospectus notes that over 10 years, assuming a 5% return each year, an investor with a $10,000 investment could pay as much as $1,417 in fees.

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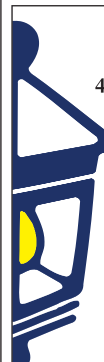

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Less work for SEC judges?

Bill would give defendants option of having their case heard in court

By Mark Schoeff Jr.

A Republican lawmaker wants to curb the ability of the Securities and Exchange Commission to try enforcement claims before in-house judges, a process that has generated much controversy, including protests from investment advisers.

Rep. Scott Garrett, R-N.J., introduced legislation Oct. 22 that would give defendants in SEC cases the option to have the matter tried in a federal court instead of in forums presided over by an SEC administrative law judge.

"Strong enforcement of the securities laws is an essential part of the SEC's mission to protect investors and maintain a fair and efficient marketplace, but in recent years the agency has transformed into a veritable judge, jury and executioner with its blatant overuse of their in-house courts," Mr. Garrett, chairman of the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, said in a statement.

Mr. Garrett added: "Every American has the constitutional right to defend themselves before a fair and impartial court, and the Due Process Restoration Act will go a long way towards protecting the rights of the innocent while maintaining the ability of the SEC to punish wrongdoers."

The SEC's increasing use of administrative forums has spurred a number of lawsuits, including some from investment advisers.

DEFENDANTS HAMSTRUNG

Opponents say the administrative process does not allow defendants the same latitude to make their cases as they have in a jury trial. Supporters argue the system is faster and less costly than a court proceeding, provides protections and uses judges with expertise in securities laws.

In addition to allowing defendants to move their cases to federal court, Mr. Garrett's bill would raise evidence standards for cases that remain in the administrative forum.

In reaction to criticism of the ALJ system, the SEC recently passed a rule that would provide defendants greater discovery opportunities and make other reforms to the process.

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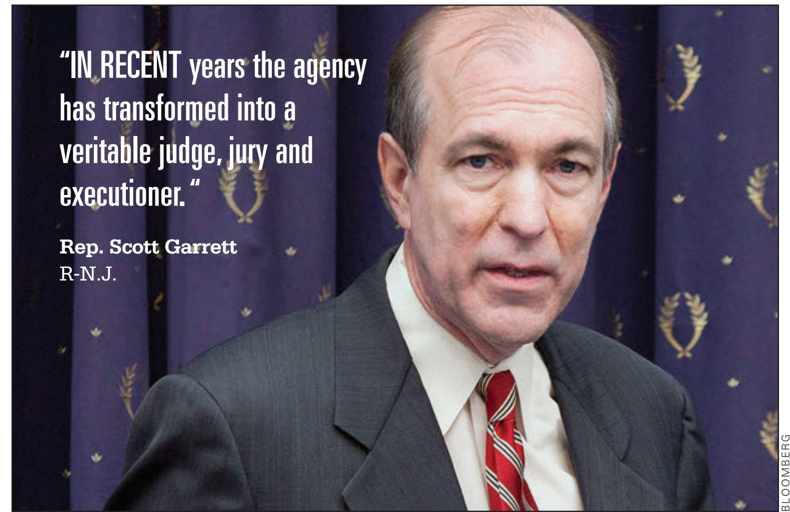

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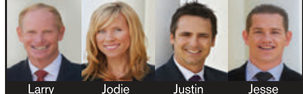

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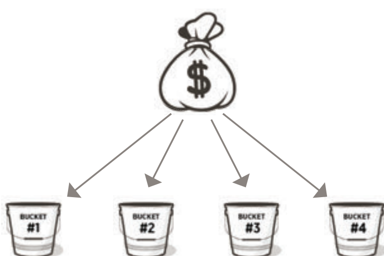

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New bill aims to curb senior fraud

By Greg Iacurci

Two senators introduced bipartisan legislation last Thursday that aims to cut down on elder abuse by encouraging advisers and financial institutions to report financial fraud targeting American seniors.

The Senior$afe Act of 2015 is sponsored by Sens. Susan Collins, R-Maine, and Claire McCaskill, D-Mo., the chairwoman and ranking member, respectively, of the Senate Special Committee on Aging.

The act would protect banks, credit unions, investment advisers and broker-dealers, and their employees, from civil or administrative liability, as long as employees receive training in how to spot and report predatory activity and reports are made "in good faith" and "with reasonable care," according to the bill.

Current privacy laws make it difficult for these entities to report any potentially fraudulent activity, according to a statement from Ms. Collins. Indeed, only one in 44 cases of financial abuse is ever reported, according to the National Adult Protective Services Association.

The MetLife Mature Market Institute estimates annual financial loss of $2.9 billion due to elder financial abuse.

1
Number out of 44 cases of financial abuse that is reported

The legislation "will empower and encourage our financial service representatives to identify warning signs of common scams and help stop financial fraud," Ms. Collins said.

It's based on Maine's Senior$afe program, an initiative launched last year that's designed to train financial professionals to detect and report senior financial abuse.

The proposed legislation also comes on the heels of related activity among regulators.

Last month, the Financial Industry Regulatory Authority Inc.'s board authorized the regulator to propose a rule to require broker-dealers to obtain the name and contact information of a person the customer trusts. It also would allow firms to freeze senior investors' accounts when there's reasonable belief of financial fraud.

The North American Securities Administrators Association proposed model state legislation that would mandate disclosures to state regulators and adult protective services if there's reasonable belief of elder financial abuse. Rules also would allow advisers to contact trusted third parties or delay fund disbursement for at-risk seniors.

giacurci@investmentnews.com
Twitter: @gregiacurci

SEC finally OKs crowdfunding rules

Startups, small businesses free to raise money by selling stock on the Web

Bloomberg News

Startups and other small businesses will be free to raise money by selling stock over the Internet under new rules adopted by the Securities and Exchange Commission.

Equity crowdfunding standards approved on a 3-1 vote last Friday stipulate that such firms can raise as much as $1 million annually by offering shares to investors online.

"This rule making has generated tremendous interest from potential issuers, investors and intermediaries," SEC Chairwoman Mary Jo White said before commissioners voted on the rules. The framework "strives to be workable for issuers and delivers a strong set of investor protections," she said.

PART OF JOBS ACT

The SEC is required to permit equity crowdfunding under the 2012 Jumpstart our Business Startups Act, which promised an easier way to raise money for firms that can't get bank loans or venture capital. Even so, it took the SEC more than three years to adapt the concept to securities markets, as regulators struggled to balance demands for fewer requirements with warnings about potential fraud.

A company using equity crowdfunding is limited to raising a maximum of $1 million per year. Those raising smaller amounts would have to share financial statements and income-tax returns with investors. In a change from a proposal released in October 2013, the agency will allow a business raising more than $500,000 to provide financial results that have been reviewed by an accountant rather than formally audited.

> "THIS RULE MAKING has generated tremendous interest from potential issuers, investors and intermediaries."
>
> **Mary Jo White**
> Chairwoman, SEC

"These investor protections are not just important to the college student, to the grandmother and to the working mom who jump on the Internet wanting to experiment with crowdfunding," said Commissioner Kara Stein, a Democrat. "They also protect the small businesses that want a reliable market to raise capital."

Crowdfunded shares will be open to any investor regardless of their income or net worth. Those who buy stock will have to hold it for at least one year before trying to sell. Under the rules, crowdfunding must be done online through a broker or funding portal that provides financial information about the companies and discloses how much money it makes for selling the shares.

People whose income or net worth is less than $100,000 would be limited to investing a maximum of $5,000 annually. Investors with income and net worth greater than $100,000 could contribute as much as 10% of their annual income or net worth, up to a maximum of $100,000 in one year. The restrictions are intended to limit the downside for shareholders who take stakes in riskier companies.

STERN OBJECTION

The investment limitations are slightly more strict than what the SEC outlined in its 2013 proposal and drew a stern objection from Republican Commissioner Michael Piwowar.

"Even if you are Warren Buffett or Bill Gates, you are limited to investing no more than $100,000 during any 12-month period," said Mr. Piwowar, who voted against the rule. "While crowdfunding was intended to be a treat for the smallest and least sophisticated companies seeking to raise capital, today's rules are full of tricks."

Firms fined over fund overcharges

Continued from Page 6

ordering restitution for similar overcharges on mutual fund sales.

The eight firms cited in this story agreed to pay back clients proactively, and therefore avoided fines.

Edward Jones, which will pay $13.5 million in restitution, said it has made changes to correct the problem and noted its cooperation in the matter.

"Edward Jones is simplifying the mutual funds offerings for some firm-held retirement accounts to help ensure this problem doesn't occur in the future," spokesman John Boul said in a statement.

Stifel Nicolaus will pay $2.9 million in restitution. It did not have an comment available.

'COOPERATION'

Janney Montgomery Scott, which will pay $1.2 million, said in a statement it was recognized by Finra for its "cooperation to identify the issue proactively" and modify its internal procedures.

Axa Advisors, which will pay $600,000 in restitution, said it strives to meet the industry's best practices and regulatory requirements.

"We have fully cooperated with the Finra investigation into this industrywide issue and are pleased to have reached a resolution with Finra," a statement from Axa said.

Stephens, which will pay $150,000, did not have an comment.

lskinner@investmentnews.com
Twitter: @skinnerliz

By Mary Beth Franklin

Assuming President Obama signs the legislation, these are the changes to look out for:

File and suspend

If you have already filed and suspended your benefits in order to trigger spousal benefits for your wife or husband, and/or dependent benefits for a minor or disabled child, your family will continue to receive benefits on your earnings record.

If you are 66 or older within the first six months after the law is enacted — approximately May 1, 2016 — you can still request to file and suspend your benefits to trigger spousal or dependent benefits.

After May 1, 2016 (approximate date), the rules for file and suspend will change. No one will be able to collect benefits when the primary beneficiary files and suspends. And the person who files and suspends will no longer be able to request a lump sum payout of suspended benefits at a later date.

After May 1, 2016, the only use of file and suspend will be for those people who claimed reduced Social Security benefits before full retirement age. They will still be able to suspend benefits in order to earn delayed retirement credits of 8% per year between ages 66 and 70. But no one will be able to collect spousal or dependent benefits while the primary beneficiary suspends benefits.

Restricted claim for spousal benefits

Married and divorced spouses who are already collecting spousal benefits — worth half of their spouse's or ex-spouse's full retirement age benefit amount — can continue to collect those spousal benefits and switch to their own larger retirement benefit at age 70.

Anyone who is age 62 or older by the end of 2015 will retain the right to claim just spousal benefits when they turn 66 once the other spouse either claims Social Security or if that spouse had requested to file and suspend their benefits within six months of enactment of the legislation. Qualified ex-spouses who have been divorced at least two years can collect spousal benefits at age 66 even if their former spouse has not yet claimed benefits as long as that former spouse is at least 62 years old.

Anyone who is younger than 62 at the end of 2015 will not be permitted to collect just spousal benefits in the future. If they are entitled to both a retirement benefit on their own earnings record and a spousal benefit because they are married (or divorced after at least 10 years of marriage) to someone who is eligible for benefits, they will be deemed to file for both benefits at the same time and receive the higher of the two amounts.

mbfranklin@investmentnews.com; Twitter: @mbfretirepro
Mary Beth Franklin is a certified financial planner.

Social Security blues for advisers

Continued from Page 1
said Don St. Clair, owner of St. Clair Financial. "They'll have to delay retirement or live on less."

Changes to Social Security claiming strategies will take effect within six months of the budget bill being enacted. President Barack Obama is expected soon to sign the measure, which sets federal spending limits for the next two years and lifts the ceiling on the federal debt limit.

Once the reforms go into effect, no one who turns 62 in 2016 or later will be able to utilize the claiming techniques. The original legislation was revised so that it would not affect payments to people who are already collecting benefits through file-and-suspend, according to congressional aides.

CLIENTS ON A SPEEDUP

The fast implementation timetable has advisers clambering to get clients who are close to retirement to speed up their decisions on whether to do file-and-suspend.

"We've reached out to anyone who may be eligible in the next six months to do it," said Blair Duquesnay, chief investment officer at ThirtyNorth Investments. "We want to make sure we don't miss anyone who may be able to take advantage of it."

Jim McCarthy, managing director of Directional Wealth Management, also is reviewing his client database with an eye toward the expiration of file-and-suspend.

"We'll run the numbers and see if it makes sense to implement the claiming strategy," he said.

Under file-and-suspend, a claimant can file for benefits at the full retirement age of 66 and put off receiving them until he or she retires at 70. Over those years, the benefit grows at about an 8% annual rate. Meanwhile, his or her spouse can claim the spousal benefit — one half of the claimant's benefit at full retirement age.

The strategy costs the Social Security Administration several billion dollars a year in revenue, according to estimates, and is seen as a "loophole" that benefits mainly the wealthy.

As congressional leaders and the White House cobbled together the budget agreement, negotiators required spending reductions to offset increases in federal spending caps. One of the areas targeted was Social Security.

The measure "closes several loopholes in Social Security's rules about deemed filing, dual entitlement and benefit suspension in order to prevent individuals from obtaining larger benefits than Congress intended," states a summary of the bill.

> "THERE ARE a lot of Americans who rely on these strategies to pick up $700 or $800 a month."
>
> **Paul Auslander**
> Director of financial planning
> Provise Management Group

But advisers say the impact of the reform will extend well beyond wealthy Social Security recipients.

"There are a lot of my clients who are nowhere near the 1% [of richest Americans] who are able to take advantage of this strategy," Mr. McCarthy said.

Paul Auslander, director of financial planning at ProVise Management Group, said Congress will be criticized for the Social Security moves.

"There are a lot of Americans who rely on these strategies to pick up $700 or $800 a month, and that makes a big difference in their quality of life," he said.

Usually changes to Social Security occur over years. This time around, it happened during backroom budget negotiations over the course of days.

"This is coming out of left field," Mr. Kalscheur said.

The legislation did address concerns of drastically rising Medicare premiums for base payers -— which some predicted would have risen 52% to $159.30 per month — and will keep the lowest rate at $104.90. But it would place a surcharge on high-income recipients of Medicare, which will be costly for wealthy beneficiaries.

mschoeff@investmentnews.com
Twitter: @markschoeff

Estimated Medicare changes

Modified adjusted gross income (MAGI)	Medicare Part B Premium + IRMAA 2015*	Estimated Medicare Part B Premium + IRMAA 2016
Individuals $85,000 or less, married couples $170,000 or less	$104.90	$104.90 (held harmless),** $120 (not held harmless)
Individuals $85,001 - $107,000, married couples $170,001 - $214,000	$146.90	$171
Individuals $107,001 - $160,000, married couples $214,001 - $320,000	$209.80	$243
Individuals $160,001 - $214,000, married couples $320,001 - $428,000	$272.70	$315
Individuals above $214,001, married couples above $428,001	$335.70	$387

Estimates are based on the budget proposal of Oct. 28. *IRMAA is income-related monthly adjustment amount. **The Social Security Act contains a "hold harmless" provision that protects the vast majority of Social Security beneficiaries from paying a larger increase in Medicare Part B premiums than they receive in a Social Security COLA increase in order to avoid a net reduction in their Social Security benefit.

Source: Katy Votava, Goodcare.com

TECH CONNECT

Reach investors by posting instructive videos on YouTube

All advisers really need is a quality microphone and valuable content

By Alessandra Malito

Turns out YouTube is more than just a website for music videos and cat clips — viewers appreciate educational and informational segments, as well.

"Every day, people watch hundreds of millions of hours on YouTube," Sundar Pichai, chief executive of Google, said during parent company Alphabet Inc.'s most recent earnings call. "People turn to YouTube because they want to research, buy or fix a product."

Advisers can take advantage of this trend by offering research-driven videos.

TO-THE-POINT MESSAGES

"We are starting to see more educational videos rather than self-promotional videos," said Amy McIlwain, author of "The Social Advisor: Social Media Secrets of the Financial Industry" (2012) and vice president of social and digital strategy at Moore Communications Group.

"It is this educational-type video educating consumers that is really powerful and what consumers are seeking," she said.

"WE ARE STARTING to see more educational videos rather than self-promotional videos."

Amy McIlwain
Author
"The Social Advisor"

Joe Bert, founder of Certified Financial Group Inc., said he and his firm use their videos, which appear on YouTube and as television segments, to convey direct and to-the-point messages. His firm has produced videos on Medicare, "money milestones" and how millennials can become millionaires.

'THE NEW TV'

"YouTube has become the new TV," Mr. Bert said. "People today want to watch video as opposed to reading, so if you have something compelling, where you can tell a message, they will want to watch that."

Advisers recognize YouTube's potential, along with that of other social media channels. A 2015 Cogent Reports survey found that YouTube is currently the No. 1 platform used by advisers, with 75%, followed by 74% who say they use LinkedIn, 65% who say they use Facebook and 32% who say they use Twitter in some professional capacity.

Mr. Bert said while some advisers are using YouTube now, more are bound to jump onto the video website in the future. It may get overwhelming.

"It can only increase, and frankly become saturated," Mr. Bert said. But there's potential to dissect the competition.

Joe Bert: "People today want to watch video as opposed to reading."

YOUTUBE

"If the videos are well done, it will establish or reinforce credibility," he said.

Mr. Bert added that advisers should invest the time to do a series of videos because one or two won't cut it.

Videos should be about 90 to 120 seconds long. Ms. McIlwain said no fancy studio is needed, just a quality microphone and valuable content. Some people even just sit at their desks.

"That's what people are really looking for: authenticity and transparency," Ms. McIlwain said. "Don't try to memorize a long script. Be authentic and show your expertise and knowledge in this area."

amalito@investmentnews.com
Twitter: @malito_ali

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ETF providers State Street, Invesco may be next to launch robo-advisers

By Alessandra Malito

As more and more firms latch on to a robo-adviser, one study says two more big players could be next: State Street and Invesco.

Silver Lane Advisors, a mergers-and-acquisitions consultancy to financial services firms, released a robo-adviser study last Wednesday that said automated investment platforms are here to stay, and traditional advisory firms are catching on.

But there are other players in the mix now, including The Vanguard Group Inc. and its robo Personal Advisor Services, and BlackRock Inc., which recently acquired retail robo-adviser FutureAdvisor. Vanguard and BlackRock differ from some of the other contenders because they have their own products to offer.

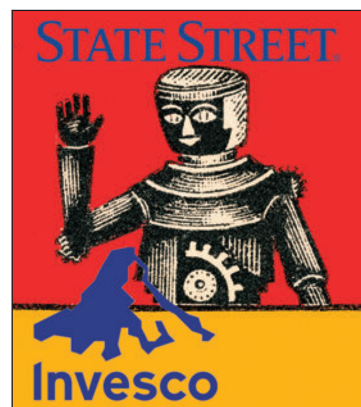
It would be a natural move for State Street, which owns exchange-traded-fund provider SPDR, and Invesco, which owns ETF provider PowerShares, to roll out their own robos in order to keep up with their major competitors.

"They are probably the two most dominant players in the ETF world that don't have a strategy on the robo front," said Peter Nesvold, managing director with Silver Lane Advisors. "It is a very natural complement, because to some degree, a robo-product is a really terrific interface with a strong line-up of ETFs behind it."

Having robo-advisers would put State Street and Invesco within arm's reach of retail consumers, who would have direct access to their products.

"It's a little bit like cutting out the middle man," Mr. Nesvold said.

Neither State Street nor Invesco responded to a request for comment.



ISTOCK COMPOSITE

Mr. Nesvold said some firms may not want to jump on the robo bandwagon for fear they would be cannibalizing their own pricing, but it is a clean step for these ETF-owning firms to build or buy an automated investment platform, he said.

POSSIBLE CONFLICT

"In some ways, they have an advantage," said Sean McDermott, a lead analyst for Corporate Insights. The fund companies own the underlying products, while startup retail robos such as Betterment and Wealthfront employ third-party products.

"The flip side is there might be a conflict of interest there," he said. Some investors may question whether they are getting conflict-free advice if their portfolios are always stocked with the same products, rather than switching brands if one becomes better than another.

"As new players have entered the space, we've continued to grow faster," said Jon Stein, chief executive of Betterment. "Customers continue to respond well to our customer-aligned, unconflicted model."

But retail-only robos will continue to face growing pressures.

A Corporate Insight study this year found robo-advisers were giving paid advice on $21 billion in investor assets as of July, a 34% increase from the previous year. But a recent Cerulli Associates Inc. report found robos will need to grow on average by 50% to 60% per year for the next six years to attain $35 billion each in assets under management. Cerulli says that level of assets is necessary to stay competitive in the business-to-consumer model.

"We think a few of them will continue to operate as direct-to-consumer, and many will find it difficult faced with increased competition," Mr. McDermott said. "We are at the intersection where you have big firms looking to make acquisitions and new startups open to acquisitions."

amalito@investmentnews.com
Twitter: @malito_ali

Voya accused of smearing broker

Continued from Page 5

and others were personally trying to get her to stay. When [Ms. Thomas] said no, they dinged her U5."

A Voya spokesman, Joseph Loparco, did not respond to Mr. Fischer's comment regarding Voya and Ms. Thomas' employment record. In an email to *InvestmentNews*, Mr. Loparco wrote: "We have no comment other than to say we abide by Finra filing rules."

Finra rules state that no broker-dealer member or person associated with a broker-dealer shall file with Finra registration information that is incomplete or inaccurate so as to be misleading.

According to the U5, Voya wrote that Ms. Thomas "was permitted to resign while on heightened supervision for violation of firm policy regarding use of unregistered email." According to the form, Voya answered "yes" to the following question on the U5: "Did the individual voluntary resign from your firm, or was the individual discharged or permitted to resign from your firm, after allegations were made that accused the individual of: violating investment-related statutes, regulations, rules or industry standards of conduct?"

A HAUNTING ANSWER

Answering that question with a "yes" can haunt advisers because it can prevent them from working in the securities industry. Broker-dealers are increasingly reluctant to do business with such advisers because of fear of drawing more scrutiny from securities regulators.

Ms. Thomas, who is based in San Gabriel, Calif., did not return a call to comment for this article.

"She's upset and does not agree with the accusations," Mr. Fischer said, adding that Ms. Thomas and her team were among the top producing groups at Voya, with $300 million in assets and $5 million in annual production, known as gross dealer concession.

According to her BrokerCheck report, Ms. Thomas, who handles 2,000 clients, started in the securities industry in 1996. She had a clean employment record except for a customer complaint in 2000 that was eventually denied, Mr. Fischer said.

"That's a great track record," he said. "We're excited to have her."

bkelly@investmentnews.com
Twitter: @bdnewsguy

Fiduciary freeze bill on way to Senate

Continued from Page 5

significantly increase liability risk and regulatory costs for brokers, making giving and receiving advice more expensive.

When Ms. Wagner introduced a similar measure in 2013, it drew support from 30 Democrats in a floor vote. This time around, Democrats who had previously supported the legislation abandoned it.

DOL EFFORTS

Rep. Gwen Moore, D-Wis., has raised concerns about the DOL rule. But she said she changed her mind on Ms. Wagner's bill because the DOL held approximately 100 meetings with consumer and industry groups and has taken two rounds of comments. She has expressed confidence that the agency will improve the proposal before it is finalized, likely in the first few months of next year.

"The SEC has yet to begin to undertake a related rule making five years after the DOL began the process, so requiring the DOL to wait until after the SEC acts to issue a rule would only delay these important consumer protections," Ms. Moore wrote in a letter to colleagues last Tuesday. "At this point, Congress needs to partner with DOL, industry and retirement savers toward the best possible final rule to protect and encourage retirement savings."

GETTY IMAGES

Rep. Gwen Moore: Changed her mind, won't support Wagner bill.

In addition to the veto threat from the White House, another obstacle is that no champion of the bill has yet emerged in the Senate.

"Our expectation is that the bill will not get significant Democratic support [in the House], and that lessens the chance it will be taken up in the Senate," said Barbara Roper, director of investor protection at the Consumer Federation of America.

A larger threat to the DOL rule is a possible amendment — known as a rider — to funding legislation that must pass by Dec. 11 to keep the government open. A bipartisan budget agreement passed by Congress last week that sets spending limits and raises the debt ceiling did not include so-called riders. But they could pop up on the bill in December that funds specific agencies.

mschoeff@investmentnews.com
Twitter: @markschoeff

Warren rips annuity sales incentives

Continued from Page 4

buried in lengthy prospectuses, leaving investors vulnerable to sales professionals who are trying to win an award rather than find the best investment products for their clients, according to the report.

"Companies shouldn't be allowed to offer expensive vacations, prizes and other kickbacks to agents in exchange for selling costly, second-rate investment products to unsuspecting customers," Ms. Warren said in a statement.

DIRECT INCENTIVES

Nine of the companies that responded to Ms. Warren's queries said they provide incentives directly to agents. For instance, American Equity and Lincoln Financial offered trips to San Francisco and South Africa, respectively, for hitting sales targets.

Ten of the 15 companies in the survey said they made incentive payments to third-party marketing organizations that then passed them on to agents.

Two of the 15 companies said they provide no noncash incentives to agents either directly or indirectly.

An insurance industry organization disputed Ms. Warren's findings.

The report "may raise inappropriate and unnecessary worries among retirees and workers considering retirement about an insurance product that can provide financial security and peace of mind," Carl Wilkerson, vice president and chief counsel for the American Council of Life Insurers, said in a statement.

> "THIS INVESTIGATION highlights the need for a strong conflict-of-interest rule to protect the savings of families."
>
> Sen. Elizabeth Warren
> D-Mass.

The group, which said life insurers paid $74 billion in annuity benefits last year, maintains that the products have adequate oversight.

"The senator's report misrepresents the comprehensive regulatory framework that governs conduct in the sale of insurance products and protects consumers' interests," Mr. Wilkerson said.

The antidote to harmful annuity sales, according to Ms. Warren, is a Labor Department fiduciary proposal designed to curb incentives for brokers and insurance agents to steer clients into high-fee products.

"This investigation highlights the need for a strong conflict-of-interest rule to protect the savings of families trying to save for retirement and to ensure a level playing field for companies and advisers who want to do right by their clients," Ms. Warren said.

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InvestmentNews

Death of the regional brokerages

Continued from Page 1

And Advest, poor Advest. In 2001, it was sold to the MONY Group Inc., which was then acquired by Axa Financial. Four years later, Axa sold MONY to Merrill Lynch & Co. After that, Advest's advisers scattered.

Over the past 20 years, many regionals had similar fates, acquired by a bank or insurance company looking to increase distribution of its products or another securities house in a drive to boost its head count. The success of many of the mergers is questionable. Old loyalties between advisers and management disappear when senior executives are replaced. Advisers find new firms when retention bonuses run out.

DECLINING NUMBERS

The number of broker-dealers registered with the Financial Industry Regulatory Authority Inc. — which includes all types of firms, not just regionals — has declined steadily since the credit crisis. With technology and compliance costs on the rise, and a decrease in the margins on money market accounts because of record-low interest rates, running any type of broker-dealer has become more expensive. Finra reported 4,020 broker-dealer members as of September. That's 12.2% fewer brokerage firms than five years ago.

Of course, regional firms still exist, though their numbers are dwindling. Industry observers routinely point to national or large regional firms such as Raymond James Financial Inc., Stifel Financial Corp., and Robert W. Baird & Co. as firms that have been able to grow but maintain that special "regional firm" quality of service and close-knit culture that financial advisers like. Large regionals generally don't like to be branded that way and neither Raymond James nor Baird would agree to be interviewed for this story. Spokesmen for Stifel didn't return a reporter's phone call.

ISTOCK

Registered reps, investment advisers and securities professionals routinely lament the passing of the regional firms.

Terry Lister, a veteran industry attorney who started his career in 1981 at a regional firm, Hanifen Imhoff Inc. in Denver, said the regional broker-dealer had a role in the marketplace. "It was local and you were dealing with local people. The investment banking and municipal finance was being done by people you knew as opposed to some guy in New York.

"The theory was that the regional firm would take a deal that the people in New York wouldn't because it was unique or too small," said Mr. Lister, who left Waddell & Reed Inc. this year and is now an industry consultant. "The bankers and underwriters knew the owner of the business because they grew up together.

"The equity underwriting business is so different today," Mr. Lister said. "IPOs and deals that were bought by individuals are now bought by institutions, and the regional firms couldn't do deals big enough to feed institutions like the hedge funds, mutual funds or sovereign wealth funds. The regional firms have been pushed out of the IPO market because there [are] no deals of a size they can handle. With municipal finance, it's the same thing. The deals are being done by big firms in New York."

Indeed, almost half of the top 50 municipal bond underwriters from 1996 to 2000 have closed, been taken over or merged with a rival, according to an *InvestmentNews* analysis of data provided by Thomson Reuters. Those include such regional stalwarts as Morgan Keegan & Co., which was acquired by Raymond James in 2012, and Stone & Youngberg, which Stifel Financial bought in 2011.

"There are three reasons for the demise of the regional firm," said Tom Halloran, president of Voya Financial Advisors Inc., an independent broker-dealer. "Remember Y2K? At the time a lot of us were being held hostage to technology changes and technology costs. The tech people owned budgets they never had before."

> "THE SECOND WAVE of regionals went out because of a wave of investor lawsuits."
>
> **Tom Halloran**
> President
> Voya Financial Advisors

TECHNOLOGY COSTS

Rising technology costs, still a source of pain for many small or midsize securities firms, pushed many regional broker-dealers to merge, said Mr. Halloran, who during the 1990s worked in the wholesaling division of Putnam Investments. He was based in Cleveland and worked regularly with regional firms such as McDonald and Roney & Co., which also was acquired by Raymond James.

"In addition, compliance at firms was raising more issues," he said. "After the Internet bubble burst, the second wave of regionals went out because of a wave of investor lawsuits."

"And finally, the regional firms' capital markets couldn't compete anymore," Mr. Halloran said. "In the '90s, you had IPO millionaires coming to fruition from companies that made no money. After that, regional firms couldn't get allocations to shares of an IPO."

One industry observer noted that although many regional firms are no longer in business, the spirit of such securities houses lives on.

"In my mind, the definition of a regional firm has changed," said Frank Campanale, an industry consultant who most recently was the chief executive of Lebenthal Wealth Advisors. "As big as it is, Raymond James operates like a regional firm; it has the look and feel and general operational structure of a regional. It's not a big wirehouse or bank, and that's a compliment. It doesn't impose a bank culture on its advisers. Baird is a fabulous company, too."

And rising from the ashes is Benjamin F. Edwards & Co., led by Tad Edwards, scion of the family that started A.G. Edwards more than a century ago, Mr. Campanale noted. "It's becoming a new regional firm, like the old A.G. Edwards," he said.

"The culture of a regional firm is not something you can create at a brokerage firm by throwing money at it or buying it," Mr. Campanale said. "It doesn't work that way. Culture is the function of a shared ideology and a physical manifestation of it because the advisers have some equity, some stake in the company as well. It makes a difference."

bkelly@investmentnews.com
Twitter: @bdnewsguy

Finra chief Ketchum to retire in 2016

Continued from Page 1

said Don Runkle, former chief compliance officer with Raymond James Financial Services Inc. and current director of consulting services at Edgerton and Weaver.

Mr. Ketchum, who turns 65 in December, said in an interview last Friday he has been talking to the Finra board for "a long time" about retiring. As head of the regulator, he spends two days in New York and three days each week in Washington, commuting from his home in suburban New York.

'RIGHT TIME'

"Now is the right time to hand over the reins," Mr. Ketchum said. "Finra is the best job I've had in my life. I'm tremendously proud of what we have accomplished."

He said he would like to depart sometime next summer, depending on when the board chooses his replacement.

Over the next eight or more months that he will remain at Finra, Mr. Ketchum said he wants to continue to upgrade the regulator's ability to use technology and market data to target examinations and enforcement. Finra is doing "cross-market surveillance" on equities and is expanding the initiatives to option trading.

Another priority is working on rules that would increase price transparency in the fixed-income markets.

"These are examples of things I'd like to see great progress on in 2016," Mr. Ketchum said.

Practically a career regulator, with prior stints as chief executive of NYSE Regulation and president of the Nasdaq Stock Market Inc. and NASD, Finra's predecessor, Mr. Ketchum would often get together for impromptu lunches with people in the securities industry.

> "I'VE FOUND him unusually accessible and considerate in the process. He would listen and accept criticism."
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> **Don Runkle**
> Director of consulting services
> Edgerton and Weaver

"I've found him unusually accessible and considerate in the process," Mr. Runkle said. "He would listen and accept criticism."

Under Mr. Ketchum's watch, Finra has launched several initiatives. Those include the high-risk broker program, improvements in BrokerCheck, the expansion of reporting and data of over-the-counter secondary market fixed-income trades, and the expansion of Finra's responsibilities across stock and option trading.

"It has been a pleasure working with Rick over the past several years," Dale Brown, president and CEO of the Financial Services Institute Inc., a trade group for independent broker-dealers, said in a statement. "While at times we had our differences, he was always willing to listen, understand and consider the perspectives of all stakeholders."

Of course, Mr. Ketchum has had difficulties to overcome during his stint as Finra CEO. He took over the top job the year markets bottomed — 2009 — and the number of firms overseen by Finra has declined on his watch. Finra failed in its attempt to become the de facto regulator of thousands of registered investment advisers overseen by the states and the Securities and Exchange Commission, and it also failed to win the securities industry's support for a massive data collection system known as CARDS.

NO CARDS REVIVAL

Although he intends to keep pushing Finra to improve its use of data analytics, Mr. Ketchum said he will not attempt to revive a proposal for CARDS.

The initiative, which was touted by Finra as a way to quickly pinpoint investment products that are prone to fraud, was shelved earlier this year amid industry protest about the potential costs of compiling reams of account information.

"We have no intention at this point to return to a single database, such as CARDS," Mr. Ketchum said. "We don't need CARDS to have plenty of data with respect to firms."

"In some respects he's made Finra more aggressive, but he also has attempted to understand the industry's position and where the industry is coming from," said Brian Rubin, a former NASD enforcement attorney and current partner with Sutherland Asbill & Brennan.

Prior to Mr. Ketchum's taking over the top spot at Finra from Mary Schapiro, Finra staff at times did not understand the business model of independent-contractor firms. A common criticism of Finra was its focus on the wirehouses, rivals to the independents.

"I think he understands the role that independent-contractor firms play and their overall importance," Mr. Rubin said. "He hasn't tried to push them aside or ignore them."

bkelly@investmentnews.com
Twitter: @bdnewsguy
mschoeff@investmentnews.com
Twitter: @markschoeff

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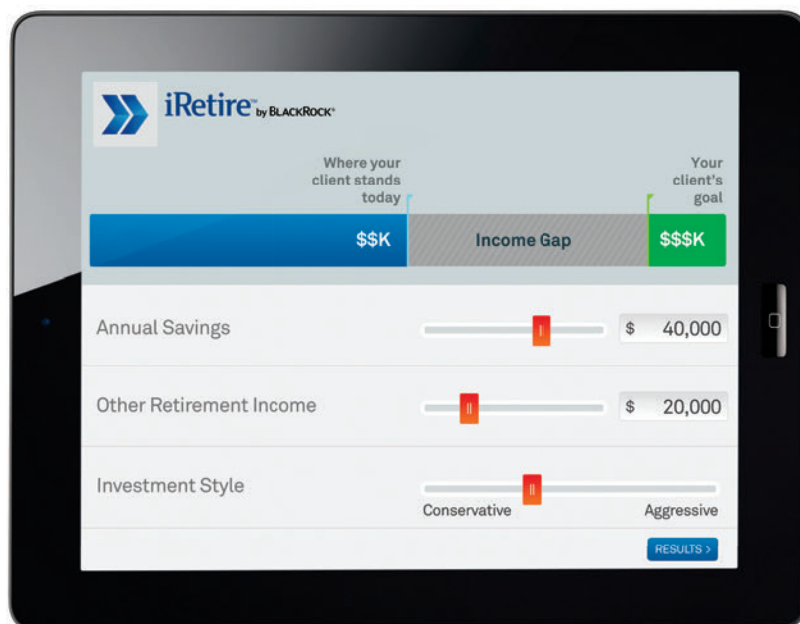

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