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Armando Castellano: Gen Xer turned to financial adviser for help with budgeting.

FORGOTTEN GENERATION

Enough about boomers and millennials. Gen Xers need advisers' help the most.

By Liz Skinner

DESPITE HAVING a nest egg of $5 million — much of it inherited — Armando Castellano was always uncomfortable spending money. So three years ago, the 45-year-old musician hired a financial adviser to help him and his wife set up a budget and do some long-range planning.

The adviser, Emilie Goldman, set up a budget with monthly allotments for clothing, cars and a dozen other spending categories. She also set up a plan to ensure that the couple won't outlive their money.

"It's completely freeing," said Mr. Castellano, who plays the French horn in regional orchestras in the San Francisco Bay area. "Now I have stability and clear boundaries."

Mr. Castellano is part of Generation X, sometimes overlooked by advisers who are paying more attention to baby boomers as they enter retirement or millennials as they look forward to inheriting their baby boomer parents' money.

GEN X

And yet, Gen X, those between 35 and 50 years old, may need more help than the other two generations. Even though they are in their peak earning years, they have the poorest financial habits, according to a January survey by Northwestern Mutual Life Insurance. The group includes more spenders than savers, and Gen Xers are also most likely to have more debt than savings, the survey found.

Continued on Page 60

Financial Engines adds human touch

The Mutual Fund Store deal seen as endorsement of using advisers in robo models

By Alessandra Malito

If ever there were doubt of the need for the human element when it comes to robo-advisers, there isn't any more.

Financial Engines, which some call the original robo-adviser, is paying $560 million in cash and stock to acquire The Mutual Fund Store, a registered investment advisory firm with $9.8 billion in assets under management.

Even more valuable than the assets, however, are the 125 retail locations and 300-plus advisers the firm offers Financial Engines, a 401(k) advisory firm with $104 billion in AUM. With these new resources, the retirement robo will offer 401(k) participants face-to-face consultations and more comprehensive financial planning.

> "IT IS AN incredible admission that this is not just going to be done in cyberspace."
>
> **Fred Barstein**
> CEO
> Retirement Advisor University

"We learned people need help in different ways," said Lawrence Raffone, chief executive of Financial Engines. "What became apparent was folks who were getting closer to retirement, they wanted more face to face and wanted us to be more holistic."

Financial Engines, which began offering online automated investment advice to 401(k) plan participants beginning in 1996, hinted in September that it would move toward more human-oriented advice. The company announced it would be a hybrid model, where clients can access their accounts online and phone in to a call center and talk to advisers for no additional fee.

> **$560M** The amount Financial Engines will pay for The Mutual Fund Store

ACCESS TO HUMAN ADVISERS

The Mutual Fund Store will provide more access to human advisers, Mr. Raffone said. There is currently a 50% overlap between where Financial Engines' clients are located and where The Mutual Fund Store's retail out-

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Retirement Plan Advisers: The debate continues over whether ETFs have a place in 401(k) plans. **Pages 14**

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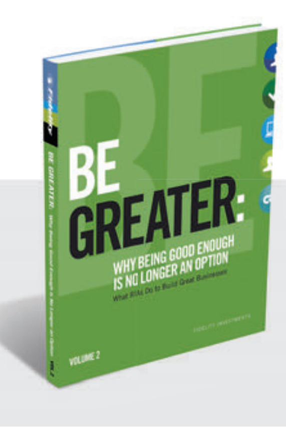

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EDITOR'S NOTE

It's time to show Gen X a little love

Generation X suffers from "middle child syndrome" — and for good reason.

Stuck between baby boomers and millennials, Gen Xers have a tendency to get overlooked by many providers of goods and services, including financial advisers.

Frederick P. Gabriel Jr.

Admittedly, we here at *InvestmentNews* also are guilty of paying scant attention to Generation X, which is loosely defined as those 35 to 50 years old. As I look through our archives, I find hundreds — if not thousands — of articles about baby boomers and their demands. We've written about their spending habits, their savings habits, and we've certainly covered advisers' efforts to court and retain baby boomer clients.

In recent years, we've also written plenty about millennials, specifically about how they're in line to become the next big holders of wealth and how most advisers have yet to crack the code for working with them.

Our coverage on Generation X, however, has been a little thin.

FORGOTTEN COHORT

With that in mind, *InvestmentNews* reporter Liz Skinner set out to look more closely at this forgotten age cohort. What she found is a generation of investors that is in pretty bad shape when it comes to their finances. In fact, 38% of Gen Xers have more debt than savings, compared with 31% of the overall population, according to a Northwestern Mutual Life survey.

"There are a lot of Gen Xers who make $200,000 to $400,000 a year and they're going broke," financial adviser Ted Jenkin, who started oXYGen Financial seven years ago to focus in part on serving Gen X, told Liz in her story which begins on Page 1.

She also found a number of advisers who have built successful practices around Gen Xers. Those advisers share their secrets for working with this extremely suspicious and cynical group.

Simply put, advisers can no longer afford to ignore Generation X. That's because the wealth held by baby boomers is very likely to pass through the hands of an Xer before it winds up with a millennial.

It's time for all of us to show Generation X a little more love.

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Correction

Figures provided by Lipper on Page 14 of the Oct. 26 issue incorrectly stated year-to-date returns for the alternative multistrategy category in hundredths of a percent instead of as full percentages. The corrected table can be viewed at InvestmentNews.com/multistrategy.

John Hancock will bring on 1,100 Transamerica advisers

By Bruce Kelly

John Hancock Financial Network Inc. said last Tuesday it was acquiring up to 1,100 advisers from Transamerica Financial Advisors Inc. Those advisers represent roughly one-quarter of those currently affiliated with Transamerica.

Upon the close of the transaction, the advisers will become affiliated with Signator Investors Inc., the independent broker-dealer of John Hancock Financial Network.

Transamerica is not exiting the independent broker-dealer space. After the acquisition closes, which is expected to occur in the next six months, Transamerica still will have more than 3,000 affiliated advisers.

In statements, the two companies said the deal was designed to allow John Hancock to acquire "certain assets" of Transamerica Financial Advisors, including 90 home office staff members who will now work for Signator.

The remaining Transamerica advisers are affiliated with World Financial Group, a financial services marketing and distribution organization controlled by Transamerica.

Terms of the transaction were not disclosed.

The Transamerica advisers who will move to Signator are independent contractors who are dually registered, as registered reps and investment advisers, said Melissa Berczuk, a spokeswoman for John Hancock.

She said the company was not disclosing the amount of assets those advisers managed. She added, however, that "they will significantly increase Signator's total assets both in the broker-dealer and the investment advisory platform."

ILLUSTRATION: GERARDO TABONES FROM BLOOMBERG PHOTOS

M&A HEATING UP

According to the 2014 *InvestmentNews* survey of independent broker-dealers, Signator Investors and Transamerica Financial Advisors had, respectively, 1,374 and 5,103 registered representatives and advisers. Signator produced $297.6 million in total revenue last year while Transamerica Financial Advisors produced $279.9 million, according to the survey.

After the tepid first half of 2015, mergers-and-acquisition activity in the independent broker-dealer industry has heated up.

In September, *InvestmentNews* reported that Next Financial Group Inc. was on the block. And last month, in the largest independent broker-dealer acquisition of the year, H.D. Vest Financial Services Inc. said it was being acquired by Blucora Inc., a company that focuses on Internet businesses, for $580 million.

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McCann named chairman of UBS Americas

Tom Naratil will succeed him as the leader of the bank's advisers in the U.S.

By Bruce Kelly

Robert McCann will be bumped up from his position leading UBS Group AG's advisers in America to a new role, chairman of UBS Americas, where he will focus on clients and strategic priorities in the region, the company announced last Tuesday.

Mr. McCann is stepping down from his current roles as president of Wealth Management Americas, president of UBS Americas and member of the group executive board.

Succeeding Mr. McCann in all three positions will be Tom Naratil, currently the group chief financial officer and chief operating officer.

The changes will take effect Jan. 1.

Mr. McCann left rival Merrill Lynch and joined UBS in 2009 in the wake of the credit crisis.

SECOND BIG CHANGE

This is the second significant change in leadership at UBS Wealth Management Americas this year. In May, Bob Mulholland, Mr. McCann's second-in-command, announced his retirement. Mr. Mulholland and Mr. McCann both are widely credited with reviving UBS' money-losing brokerage after 2009.

In third-quarter earnings released last Tuesday, Wealth Management Americas posted an adjusted profit before tax of $287 million, an increase of 24% from the previous quarter, the company said.

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GETTY IMAGES

Robert McCann: Left Merrill to join UBS in 2009 in the wake of the credit crisis.

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House to float bill to replace DOL fiduciary rule

BLOOMBERG

Lawmakers release 'legislative principles' for retirement advisers

By Mark Schoeff Jr.

A bipartisan group of House members is working on a bill that would offer an alternative to a pending Labor Department proposal to raise investment advice standards for retirement accounts.

The lawmakers released what they called "legislative principles" last Thursday that will be reflected in the measure.

The principles include requiring advisers to work in their clients' best interests; providing "clear, simple and relevant disclosure of material conflicts," including compensation and fees; and preserving proprietary products, commission-based sales and annuities.

Authors of the bill — Reps. Peter Roskam, R-Ill., Richard Neal, D-Mass., Phil Roe, R-Tenn., and Michelle Lujan Grisham, D-N.M. — said they are concerned the DOL rule, which is designed to reduce advisers' conflicts of interest, would have "unintended negative consequences" for people with modest assets.

'RULE'S IMPACT'

"We acknowledge the Department of Labor's pledge to change aspects of the regulation before final issuance, but feel more must be done to adequately address concerns about the rule's impact on the ability of low- and middle-class families to save for retirement," the legislators said in a joint statement.

They added, "If a final rule has flaws, damage can be done upon the rule's release due to the immediate changes the retirement savings industry would have to make and the likelihood that those changes could limit access to services and education for those saving to retire."

A DOL spokesperson was not immediately available for comment.

It's not clear when the bill will be introduced or whether it will require the DOL to halt the rule. Mr. Neal and Ms. Grisham were among the nearly united Democratic caucus that voted against a bill Oct. 27 that would stop the DOL proposal in its tracks.

Barbara Roper, director of

Continued on Page 58

Stifel CEO wants more from Sterne Agee IBD

Kruszewski says indie biz has lower margins

By Bruce Kelly

Stifel Financial Corp. completed its acquisition of regional brokerage firm Sterne Agee Group Inc. in June, and now Stifel's CEO and co-chairman Ron Kruszewski is looking for better performance out of the independent brokerage side of the business.

He made that clear in a conference call with analysts last Wednesday to review the firm's third-quarter earnings. When discussing Stifel's global wealth management group, he said: "The margins were lower than last year due to the independent contractors from Sterne Agee, who operate at lower margins than our traditional wealth management business."

Later in the call, in response to an analyst's question, he added: "I think overall, and I think in the industry, independent business tends to operate at lower margins. And so we've been looking at, and

DAN DONOVAN

Ron Kruszewski: Firm will continue to evaluate how Sterne fits in.

will continue to evaluate, how the Sterne businesses fit into our overall margin analysis."

Stifel's target for pre-tax margins as a percentage of net revenue is 15%, according to a company presentation for investors. It exceeded that goal with margins of 15.2% in 2014, but this year has been more difficult. The company's pre-tax margins as a percentage of net revenue were 14% for the first nine months of the year, and 12.2% for the third quarter, according to the investor presentation.

Stifel's global wealth management brokerage revenue was $169.3 million for the quarter ended in September, a 7.5% increase compared with the third quarter of 2014 and a 6.6% increase compared with the second quarter of this year. The third quarter in general was difficult for the securities industry; from June 30 to Sept. 30, the S&P 500 declined 6.7% as fears of an economic slowdown in China sparked a broad market sell-off in August.

THREE DISTINCT GROUPS

The Stifel and Sterne Agee independent contractor group is a hodge podge, comprised of three distinct group of advisers. Before it bought Sterne Agee in June, Stifel owned Century Securities Associates Inc. Through the Sterne Agee acquisition, it added two groups of inde-

Continued on Page 58

Crowdfunding comes to a client near you

Jeff Benjamin
On Investments

Investment crowdfunding is coming to the retail-investor marketplace and financial advisers who are not up to speed could be missing an opportunity to provide valuable guidance to their clients.

"I think it's a really big thing," said Doug Ellenoff, a securities lawyer at Ellenoff Grossman & Schole. "I have every belief that in five years, if we do this responsibly, we'll be looking back at this like we looked back at the start of online trading."

The Securities and Exchange Commission's Oct. 30 vote approving a lingering piece of the 2012 JOBS Act known as Title III will give retail investors unique access to private-equity investing through a fast-growing network of crowdfunding platforms.

Even though the JOBS Act — and thus crowdfunding — has been around for three years, advisers remain largely on the sidelines.

As with any new investment strategy or platform, some wrinkles, blind turns and bumps in the road should be expected, but advisers shouldn't think they can avoid crowdfunding or that it will go away or fade into the background.

"It's sensitive stuff because it involves non-accredited investors, but I call it the publicification of the private investment market," Mr. Ellenoff said.

AGGRESSIVE PUSH

The platforms will not be able to start taking money from non-accredited investors until early next year. But for financial advisers, the time to get up to speed is now because the crowdfunding platforms are gearing up for an aggressive push into the retail space.

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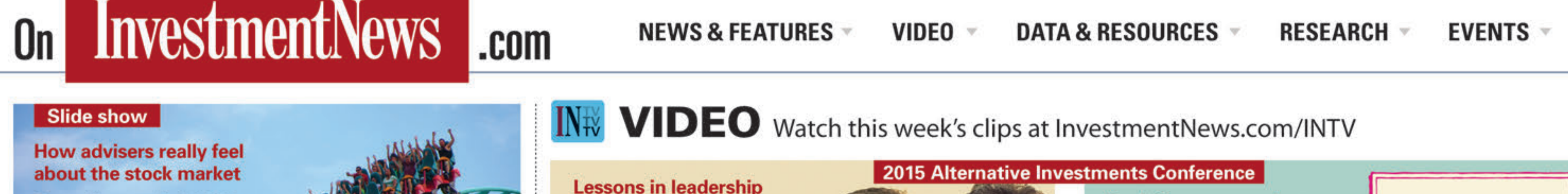

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Finra official: Focus is on discipline, not big fines

Enforcement deputy denies the SRO looks to run up the bill

By Mark Schoeff Jr.

Brokers shudder when they hear about huge Finra fines, but the organization's primary focus is the "blocking and tackling" of enforcing its rules rather than collecting huge financial penalties, a Finra official said last Wednesday.

The Financial Industry Regulatory Authority Inc. does on occasion levy substantial penalties, but most of its enforcement efforts are focused on situations involving investor rip-offs, the official said.

RULE VIOLATIONS

"It's a lot of cases that don't involve fraud, that don't involve a lot of big dollars," Russell Ryan, Finra senior vice president and deputy chief of enforcement, said at the Securities Docket Securities Enforcement Forum in Washington. "Someone's got to enforce these rule violations. That's a space that we're very good at."

Finra concentrates on supervisory lapses, sales of unsuitable complex products — especially those targeting elderly investors — and brokers engaging in outside business activities and "selling away" from the firm's menu of products.

The self-regulatory organization does not step into areas that are handled by government agencies.

"We're there really to discipline," Mr. Ryan said. "We're not in the business of law enforcement and punishing people. We do not act as a government law enforcement agency."

> "WE'RE NOT in the business of law enforcement and punishing people."
>
> **Russell Ryan**
> Senior vice president
> Finra

He tried to reassure the audience of compliance professionals that Finra doesn't try to run up the bill when it does levy fines.

"I don't sense any indications that we're out to set records," Mr. Ryan said. "We look at precedent; we look at sanction guidelines. We take it from there."

COMPLEX PRODUCTS

Brokers are struggling to follow suitability rules given the proliferation of complex products, said Jeffrey Holik, a partner at Shulman Rogers.

"The best risk mitigator is really good training," Mr. Holik said at the forum. "Often, the sales force doesn't understand what it is selling."

Sometimes when brokers testify before Finra, they still can't explain how a product works, Mr. Ryan said.

"What are you thinking?" he said of brokers who have prepared for meetings with Finra regarding unsuitable sales. "You don't understand it after you're under scrutiny for not understanding it?"

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Pimco funds go in opposite directions

Total Return outflows hit 30-month mark; Income Fund rising

Bloomberg News

Redemptions at the Pimco Total Return Fund reached 30 straight months in October as the mutual fund, once the world's largest, fell to $93.7 billion in assets.

The Pimco Income Fund continued to head in the other direction, surpassing $50 billion in assets for the first time as group chief investment officer Daniel Ivascyn's pool attracted $11.5 billion in net new cash this year, according to Newport Beach, Calif.-based Pacific Investment Management Co.

> "THE INCOME FUND benefited from defensive positioning in the energy sectors."
>
> **Daniel Ivascyn**
> Group chief investment officer
> Pimco

"The Income Fund benefited from defensive positioning in the energy sectors and the recovery in the higher-quality segments of the emerging markets," Mr. Ivascyn said.

TAPER TANTRUM

Total Return is less than a third of its peak size as investors pulled $1.6 billion from the fund in October. That was the smallest monthly outflow since July 2014, two months before Pimco's ouster of co-founder Bill Gross prompted a rush to the exits. The fund peaked at about $293 billion in April 2013, shortly before Federal Reserve policymakers sparked the so-called taper tantrum by threatening to reduce the central bank's investments in Treasuries and mortgage-backed securities, prompting investors to flee bonds.

The Total Return Fund had returned 1% this year as of last Monday, outperforming 74% of its

Continued on Page 55

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Financial firms still falling short on cybersecurity

Among the holes are security policies and disaster recovery plans

By Laura Sanicola

Financial firms, including financial advisers, still are coming up short in managing their cybersecurity efforts, according to External IT, which provides unified cloud computing to the financial services industry.

In a report — Financial Services Firms Face Further Scrutiny of Their Cybersecurity Practices: Is Your Firm Ready? — External IT examined structural deficiencies in financial firms' cybersecurity efforts.

"Security, compliance and IT are one topic and they are interchangeable and a financial business needs to be structured that way," said Sam Attias, managing director of financial services at External IT.

According to the report, financial cybersecurity is lacking in three key areas: Security policies suffer because firms fail to be proactive in their auditing of IT and IT security. There's a lack of accountability when moving company data, with employees often able to move company data to personal and home devices without tracking measures in place. Disaster recovery is also a problem, because firms lack business continuity plans outlining procedures in case of an emergency.

The report also found that financial firms don't properly vet third-party vendors before taking them on or use vendors with inadequate technology. It recommends that firms record the software and data that vendors can access, even those hired to mitigate cybersecurity risks.

ISTOCK

IN THE DARK

Brian Edelman, chief executive of Financial Computer Services Inc., a company that works primarily in cybersecurity, said advisers often don't follow these measures because they are in the dark about where to go to get their information.

"It's not that advisers are neglecting cybersecurity measures intentionally," Mr. Attias said, citing a lack of education and understanding as one of the biggest problems advisers face regarding cybersecurity. He recommended that advisers receive security awareness training, but emphasized that they do not need to become IT experts to manage cybersecurity within their firms.

"The whole idea behind risk assessment is to verify to an independent third party that the firm is complying with the requirements that have been defined for them," Mr. Edelman said. "It's a major problem when a financial adviser is not using a cybersecurity firm that understands financial services because he ends up being out of compliance as a result."

The External IT white paper follows a September Securities and Exchange Commission risk alert on cybersecurity in which the agency's Office of Compliance Inspections and Examinations said it planned a new round of examinations to gather information on cybersecurity-related controls and assess the implementation of certain controls. OCIE will focus on governance and risk assessment, access rights and controls, data loss prevention, vendor management, training and incident response.

A week after the risk alert was issued, the SEC fined an adviser at R.T. Jones Capital Equities Management $75,000 for a breach that compromised the personally identifiable information of approximately 100,000 individuals, including thousands of the RIA's clients.

Prior to the September alert, the SEC and the Financial Industry Regulatory Authority Inc. had been monitoring the compliance of financial firms with cybersecurity standards.

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GERARDO TABONES/ISTOCK COMPOSITE

Robo assets to surge 2,500% by 2020

Growth will be led by major retail firms, rather than startups: Cerulli

By Alessandra Malito

Robo-advice platforms are expected to reach $489 billion in assets under management by 2020, an eye-catching 2,500% increase from $18.7 billion in AUM today, and that surge will be led by the major retail firms.

"The growth will be primarily driven by retail-direct firms entering that space, and also later on traditional advisers figuring out how to incorporate that spectrum of offerings," said Tom O'Shea, associate director at Cerulli Associates Inc., which released a report, Retail Direct Firms and Digital Advice Providers 2015, last Wednesday.

Mr. O'Shea said that for Cerulli, the term "digital advice" encompasses any type of robo-adviser platform, including startups, such as Betterment and Wealthfront, and major firms, such as Charles Schwab & Co. and The Vanguard Group Inc. While the startups are quickly gaining traction in the industry — Betterment just passed $3 billion in AUM — Mr. O'Shea said growth will be driven by the major firms, which have far greater brand recognition in the industry.

Smaller robos will have to stay competitive by offering new services or targeting a wider audience, he said. Ultimately, all firms — and traditional advisers who want to stay in the business — will have robos, he added.

> "VIRTUALLY ALL direct-to-consumer firms will have a digital advice offering."
> **Tom O'Shea**
> Associate director
> Cerulli Associates

"We believe virtually all direct-to-consumer firms will have a digital advice offering in the next three years," Mr. O'Shea said.

STILL A HUMAN ELEMENT

The study defined digital advice as approaches that use algorithms for asset allocation and employ passive management with the use of exchange-traded funds, including account aggregation and the offer of low- or no-balance account minimums.

But just because these services are called robos doesn't mean they can't include a human element, Mr. O'Shea said.

"The word 'robo-adviser' suggests humans aren't involved in the delivery of advice," he said. "What we discovered is that's not true."

Aside from the obvious traditional advisers who take control of their own robo-advisers, startups and firms have call centers and chat services to communicate with clients.

For advisers who don't implement a robo in their firm or practice, these digital advice providers pose a threat. Robo-advisers can provide a benefit to traditional advisers, who can position the technology to cater to younger clients with fewer assets. If they do not, big firms with digital advice platforms, such as Fidelity, Schwab and Vanguard, will take over.

"That will be a huge area," Mr. O'Shea said. "There is no big barrier to entering this market for those types of firms."

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DFA unveils a unique angle on target dates

New funds employ liability-driven investing

By Greg Iacurci

Dimensional Fund Advisors is trying to break into the burgeoning target date fund market with the launch of a TDF suite that takes a unique investment approach compared with other asset managers in the defined contribution space.

Similar to other offerings on the market, the Dimensional Target Date Retirement Income Funds — the firm's first TDFs — allocate heavily to asset-growth producing securities such as global equities for young retirement savers, then shifts to a liability-driven investing strategy as a participant gets closer to retirement.

The liability-driven investing approach uses a large allocation to Treasury inflation protected securities to hedge against inflation, and interest rate and market risk. This way, DFA aims to provide a smoother and more certain level of consumption — or the drawdown of 401(k) assets — for retirees, which is a crucial consideration given the role of 401(k)s as Americans' primary vehicle for generating retirement income, according to Stephen Clark, head of global institutional services at DFA.

'DURATION-MATCHED TIPS'

In other words, the consistency, or volatility, of the retirement-income stream is the liability DFA aims to address.

"More and more, people need to rely on their 401(k) as a primary source of income, and given that's what they need to rely on, they need to focus on the right goal," Mr. Clark said.

DFA's TDFs, a collection of 13 funds launched last Monday, gradually allocate to a strategy meant to reduce uncertainty around inflation and interest rate risk, which affect the income stream of a retiree's portfolio, according to Mr. Clark.

Twenty years before a participant's expected retirement date, the TDFs begin allocating to a "duration-matched TIPS strategy," and the allocation ramps up to approximately three-quarters by the time the investor hits retirement. DFA manages the portfolios for a 25-year retirement income stream.

ROY NISWANGER

Typical TDFs allocate to nominal fixed-income securities to reduce portfolio risk as participants get closer to retirement, Mr. Clark explained. The traditional approach, which seeks to reduce volatility of the asset base, doesn't manage the right risks for participants, because it's focused on accumulation rather than drawdown risk, he said.

"We think it's important to look not only at the risk of your balance, but the risk of how much income you can afford," Mr. Clark said. "[Our approach] is framing the goal from managing the volatility of

Continued on Page 55

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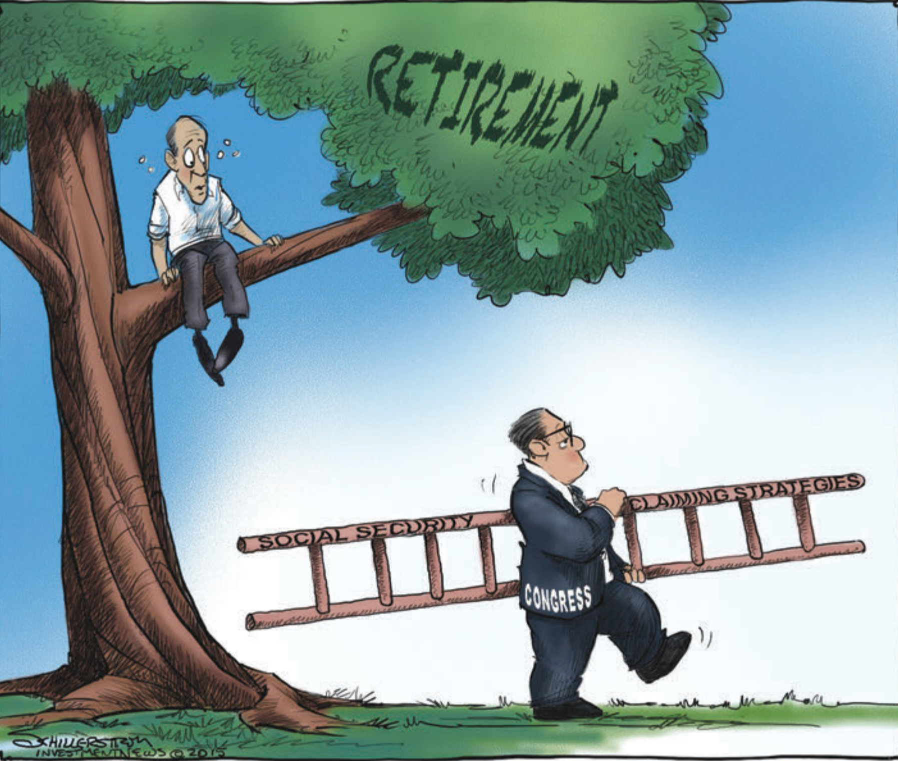
VIEWPOINT

EDITORIALS

How to help as 2 claiming strategies exit

NO DOUBT many advisers were shocked to learn that the recent budget deal struck in Congress included the elimination of two Social Security claiming strategies that could help some of their clients in retirement.



The Center on Budget and Policy Priorities told the Wall Street Journal that only about 100,000 individuals are taking advantage of these strategies right now, but with increased numbers of baby boomers set to retire in the future, that figure and the cost to Social Security undoubtedly would have gone up.

The strategies came into being during the waning months of the Clinton presidency after the passage of the Senior Citizens' Freedom to Work Act of 2000. The law was designed to give seniors incentives to work after reaching full retirement age, and the claiming strategies that evolved were totally legal.

President Barack Obama previously had criticized them, but their elimination was announced abruptly and was the result of backroom politics pure and simple.

Some pundits have applauded the elimination of the claiming strategies, asserting that they helped only the rich, but advisers interviewed by *InvestmentNews* reporter Mark Schoeff Jr. disagreed.

"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," one said.

It is a shame that decisions that can affect people's lives so greatly are made in the shadows and not out in the open where they belong, but perhaps that is just another sign of the political dysfunction in our nation's capital these days.

What advisers need to focus on now, however, is helping clients who had been counting on taking advantage of these strategies figure out what to do.

GRACE PERIOD

The good news is that depending on their age, some clients still may be able to implement the strategies, as there is a six-month grace period before they are shut down for good.

The strategies being phased out are file and suspend and a restricted application for spousal benefits. Both allow beneficiaries to collect partial benefits while accruing maximum benefits down the road.

IT'S A SHAME that decisions greatly affecting people's lives are made in the shadows.

The first thing advisers need to do is take an inventory of their clients and their ages to determine who still qualifies to take advantage of these strategies. To implement file and suspend, clients will have to be 66 or be turning 66 within six months. As for filing a restricted application for spousal benefits, clients will have to be 62 or older by the end of the year.

The next step will be to contact those still eligible to discuss their options. Some clients who still qualify may have heard that the strategies were going to be eliminated, but may not know about the grace period.

For those clients who no longer will qualify for the claiming strategies, it's back to the drawing board. It's conceivable that advisers and these clients may have baked claiming strategies into their future retirement plans. That means they will have to make up that shortfall, either by extending the number of years they have to work, cutting back on their spending during retirement, or reshuffling their portfolios and possibly taking on more investment risk. None of those options likely will be very attractive to clients.

Over the next few weeks, advisers undoubtedly are going to have to deliver some bad news.

But not delivering it would be even worse. It is in times just like this that advisers truly earn their keep and prove their worth to their clients.

It is also another reminder why machines will never totally replace advisers in the financial advice arena.

Ketchum's heir must prioritize investors

When Richard Ketchum hangs up his sheriff's badge sometime in the near future, it will truly mark the end of an era. The career regulator became the Financial Industry Regulatory Authority Inc.'s chief executive in 2009 in the middle of the financial crisis. Since he has led the self-regulatory organization, which oversees 4,000 brokerage firms and 643,000 registered representatives, the industry has undergone tremendous change.

From major advances in technology to the most significant piece of financial regulation in decades and an unrelenting economic environment that has seen countless firms close or merge, the brokerage industry has been buffeted on all sides.

Late last month, Mr. Ketchum, who will turn 65 in December, said he would retire but remain in the position until a replacement is found.

To his credit, Mr. Ketchum appears to have done well to keep Finra relevant during these turbulent times. Known as affable and approachable, he worked with the industry, not simply against it. He made sure that Finra staff members had a deep understanding of the business and the firms they oversee.

FINRA CEO did good work but may have been too close to the industry he oversaw.

Those close ties and relationships to the industry, however, also raised the question of whether he was, in fact, too close to the industry he oversaw. How deeply was he dedicated to investor protection, one of Finra's two main functions?

Take the recently passed BrokerCheck rule, for example. Last month, the Securities and Exchange Commission approved Finra's rule requiring brokerage firms to include a link to a public database containing background information about their brokers on their websites.

The rule was first proposed nearly three years ago but withdrawn twice following industry criticism about its feasibility. The watered-down rule hit the books with a whimper, without any kind of major marketing or advertising campaign to inform investors that they had a tool to more easily examine their brokers. Finra's five-week, $3.5 million campaign back in June doesn't really count.

That's one example. There are others. Remember CARDS?

To be sure, whoever replaces Mr. Ketchum will have big shoes to fill and his or her hands full.

We hope that Finra's next chief executive will continue Mr. Ketchum's good work, but beyond that, make it clear to investors and brokerage firms alike that investors come first, not the firms being regulated.

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.

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VIEWPOINT

OTHER VOICES

Lessons learned from those who've served

Robert J. McCann

As we pause to observe Veterans Day on Wednesday, I will proudly join peers across the financial industry to honor the many brave Americans whose service and sacrifice have ensured our freedom and our way of life.

What often goes unnoticed and also is deserving of recognition, is the ripple effect veterans have on the professional organizations they enter and the colleagues they work alongside when they transition to the civilian workforce. Their capacity to share what they've learned under circumstances far more difficult than many of us will ever face — that's a remarkable and humbling gift to be given, and one that I've personally benefited from.

LEADING BY EXAMPLE

Over the years, I've been fortunate to come to know hundreds of current and former service members at work and in the community. These men and women come from all walks of life and served in a number of different capacities, yet I find what they always have in common is a ready willingness to share their experiences, knowledge and training. Leading by example, they consistently bring out the best in those around them and enhance their organizations' effectiveness.

Their advice and actions have inspired this civilian to emulate the standards they've set, which can sometimes be dauntingly high. When I think about some of the things these brave men and women have generously passed on to me, three things stand out.

First: Setting a clear goal is critical to success. Every service member I've had the fortune of getting to know has been goal-oriented because that's how they've been trained. When in uniform, a mission either succeeds or fails — there's not a lot of gray area. And that success is defined by the answer to one question: Did we achieve our goal?

In business we need to have a firm grasp on where we are headed and we need to set clear metrics for how we will define success. This means establishing individual goals to ensure all team members are doing their part, as well as incremental group goals to ensure everyone is effectively working together to move an organization closer to long-term, sustainable success. The margin for error sometimes can be razor thin, so balancing ambition with pragmatism is critical when defining organizational objectives — after all, isn't that what sound risk management is all about?

SERVICE MEMBERS have in common a willingness to share their experiences.

Second: Delivering under pressure is crucial. Those who've served have told me that maintaining focus in a dynamic, high-pressure and even hostile environment is a fundamental requirement in order to perform at your best. When you're able to keep calm during challenging or volatile periods, you prove your value to those who depend on you.

Keeping a clear head and perspective is important for all of us. Our industry has experienced tremendous change in recent years — and in fact, there is a lot of volatility and uncertainty in the markets and in the world in which we live. I've learned, and I believe, that we truly serve our clients best when we're able to step back, set emotion aside and deliver thoughtful perspective. That's not always easy, but we should all commit ourselves to cultivating the ability to stay focused when others give in to groupthink and hysteria.

And the third lesson: No one can do it alone. Time and again, I've heard veteran friends and colleagues describe the military ethos that says success is never the result of a single person's actions. Rather, they've learned the value of being surrounded by a team of specialists — men and women with deep subject-matter expertise and unique, complementary skills.

ISTOCK

The same goes for the workplace. I know I rely on colleagues in all areas of the organization to do their jobs — and do them well — so that I can move my own work forward. No one has enough time or capacity to perform every function. Instead, cultivating an environment where colleagues can count on each other and understand how each of their roles ladders up to a broader success is important.

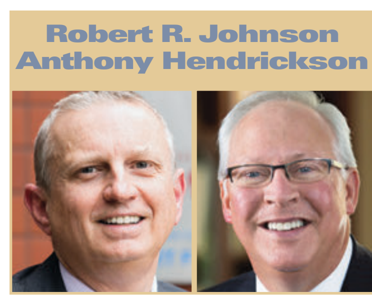
And just as accountability must be shared, we also must share praise. Giving due recognition to those who help achieve an objective is essential to keeping morale high and fostering trust. Instilling that sense of common purpose and the idea that we're part of something bigger than ourselves is the bedrock of any strong organizational culture.

It's been said that we often don't realize the full impact that we have on others. Personally, I know that I've captured lessons from people who I'm certain were unaware they were teaching me at all. As Veterans Day approaches, I look forward to thanking those touched by military service, and their families — not only for protecting our country but also for the ways they've helped me learn, grow and, I'd like to think, be a better leader.

Robert J. McCann is president Americas and president Wealth Management Americas at UBS.

Loosening mortgage standards entails risks

Robert R. Johnson
Anthony Hendrickson



A recent Fannie Mae news release outlined a new program, the HomeReady mortgage, "an innovative lending option aimed at helping creditworthy borrowers with lower and moderate incomes have access to an affordable, sustainable mortgage."

Here is the part of the news release that got our attention:

"For the first time, income from a non-borrower household member can be considered to determine an applicable debt-to-income ratio for the loan, helping multi-generational and extended households qualify for an affordable mortgage … Other HomeReady flexibilities include allowing income from non-occupant borrowers, such as parents, and rental payments, such as from a basement apartment, to augment the borrower's qualifying income."

So now with as little as 3% down, and income from a "non-borrower household member" or "non-occupant borrowers, such as parents, and rental payments," you can qualify for a Fannie Mae-backed mortgage!

We're all familiar with the prudent caution concerning co-signing on a loan (i.e., legally becoming party to a transaction in which you have no primary interest). The HomeReady Program seems like the antithetical corollary, in that the lender (Fannie Mae) is going to base a loan approval upon income from parties with whom it has no legal recourse.

ISTOCK

How is this prudent lending? And if the cycle of lowering lending standards set forth by the government prior to the financial crisis of 2008 led to imprudent lending, then what is this type of lending going to produce?

Certainly, the goal of expanding home ownership is an admirable one. The tax deductibility of home mortgage payments is a prime incentive and it has had its intended effect. Despite all of the turmoil in the housing market, approximately two-thirds of Americans own their own homes. Indeed, home equity is often the largest asset owned by families and increasingly is relied upon as a source of income during retirement.

RAISE INCOMES

The desire to expand home ownership clearly drove the decline in mortgage lending standards prior to the financial crisis of 2008. However, if policymakers want to increase home ownership, they should be implementing programs to raise incomes and living standards. You simply can't make someone creditworthy by lowering standards. This is akin to simply setting a lower passing score if not enough students are earning a passing grade.

Advisers should be aware of clients who may be overextending themselves or have family members who are overextending themselves — just because something is permissible doesn't make it advisable. They also should be aware that as lending standards deteriorate, markets may become overheated and the inevitable correction will likely be painful.

We believe that policymakers should heed the words of Nobel laureate economist Milton Friedman, who so aptly pointed out, "One of the great mistakes is to judge policies and programs by their intentions rather than their results."

Robert R. Johnson is president and CEO of The American College of Financial Services, and Anthony Hendrickson is dean of Heider College of Business at Creighton University.

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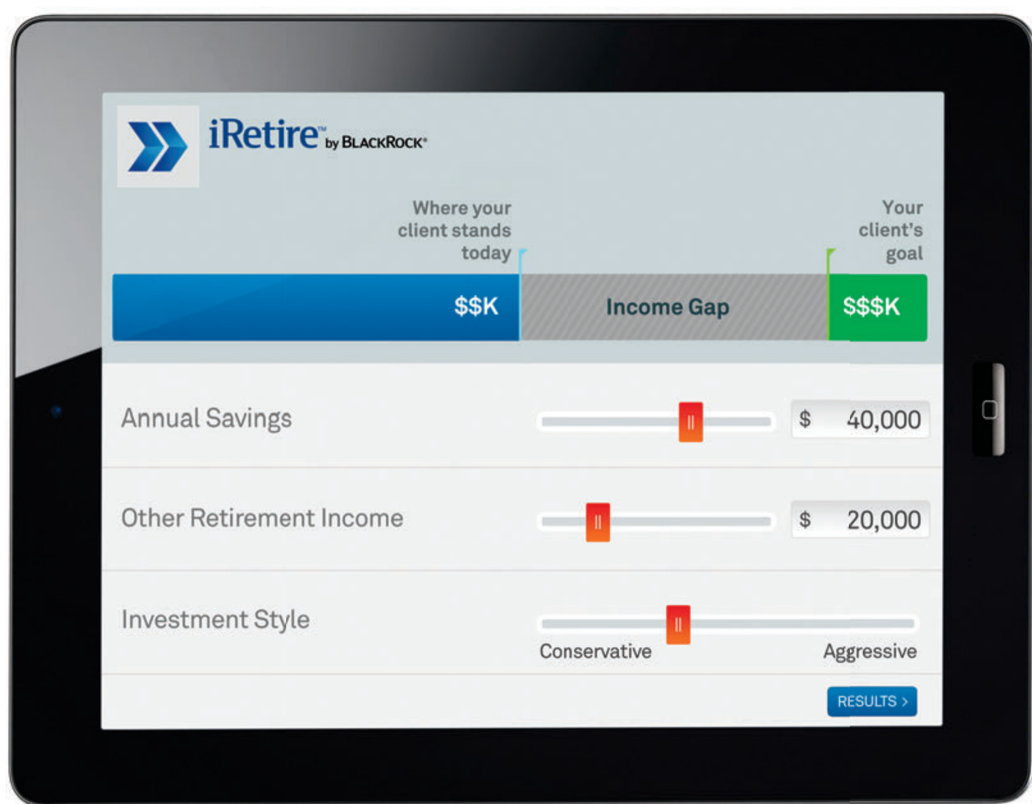

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INSIDE

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ISTOCK

ARE ETFs, 401(k)s A GOOD FIT?

Plan advisers, analysts and executives can't reach a consensus on investments' viability

By Greg Iacurci

ELLEN WEINSTEIN

RETIREMENT PLAN advisers, analysts and executives can't seem to reach consensus on the place of exchange-traded funds in 401(k)s.

Proponents point mainly to the cost benefits of using ETFs as core investments on a 401(k) menu, especially for smaller plans, which typically aren't able to negotiate investment management fees as low as their large-market counterparts.

Naysayers, however, say index mutual funds and collective investment trust funds have comparable fees, and that the structural advantages ETF investors enjoy in the retail market are lost in a 401(k) setting. They also question intraday trading in a long-term retirement vehicle meant for buy-and-hold investors.

The common ground for the two factions, though, is the expectation that ETF penetration would be a very long-term, perhaps multidecade, proposition.

At this point, ETF use can only go up. ETFs make up less than half a percent of the investment vehicles used in 401(k) plans, according to Cerulli Associates. The exposure that does exist isn't in the major 401(k) asset classes, but instead negligible amounts in sector funds, emerging markets and company stock, for example, according to the Plan Sponsor Council of America.

> *"It's going to be a long time ... before ETFs get a lot of traction."*
>
> **Jon Chambers**
> Managing director
> SageView Advisory Group

Most participants can get ETF exposure through a retail brokerage window, or indirectly through underlying fund holdings, advisers say. In those contexts, many agree ETFs make sense. But as stand-alone funds, opinions vary widely.

BOOM TIME FOR ETFS

"It's going to be a long time, if ever, before ETFs get a lot of traction in 401(k)s," said Jon Chambers, managing director at registered investment adviser SageView Advisory Group.

Outside 401(k) plans, ETFs have swelled in popularity. Net issuance of 1940 Act ETF shares ballooned 175% from 2009 to 2014, catapulting to $242 billion last year, according to the Investment Company Institute. Assets in '40 Act ETFs stood at $1.9 trillion at the end of 2014, up from $703 billion five years earlier.

The likes of Betterment and Charles Schwab Corp. have staked positions in the 401(k) market to attempt to capitalize on the boom.

Betterment, a robo-adviser, recently announced its intent to launch an all-ETF record-keeping platform, called Betterment for Business, to be rolled out in the first quarter of 2016. Schwab Retirement Plan Services Inc. launched its Schwab Index Advantage 401(k) ETF platform in February 2014, following a few years of anticipation.

The technology represents a vast departure from the platforms developed by some of the most prominent record keepers, such as Fidelity Investments, TIAA-CREF and The Vanguard Group Inc., which are tailored to the daily pricing of mutual funds rather than intraday pricing of ETFs.

Further, the ETF-based technology accounts for the fact that ETFs trade in whole shares; mutual funds, on

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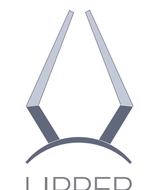

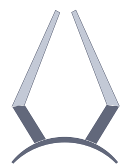

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Retirement Plan Advisers

The roll-in solution

Encouraging participants to roll assets into your plan can be a win-win

Guest Blog
Megan Yost

WHEN I TELL PEOPLE what I do for a living, I'm often met with similar responses: "I have so many 401(k) accounts. I need to do something about that." Over the years, I've heard dozens of confessions about retirement planning trials and tribulations. I've come to realize that this pressure "to do something" is what causes the most anxiety.

The truth is that life is busy for all of us. And these days, the number of retirement accounts we are juggling can be quite large. According to the Bureau of Labor Statistics, baby boomers held an average of 11.7 jobs between the ages of 18 and 48. And when we switch jobs, we have to figure out what to do about those 401(k)s.

Fortunately, the defined-contribution industry is exploring ways to automate this process to make it easier for us to move our savings from one job to the next and prevent bad behaviors such as cash-outs. Until that happens, on-the-spot interventions can help encourage participants to streamline their accounts and provide them with peace of mind that their retirement planning is in order.

To help your participants navigate the murky waters of consolidating old accounts, consider conducting a roll-in campaign. Orchestrating such a campaign doesn't have to be an elaborate task. All you need is a good rollover form and a captive audience. So be creative with the ways you enlist people to participate.

START SMALL

A successful roll-in campaign starts with a rollover form. You can use both online and paper methods — whichever will help you reach the most employees and be easiest to process.

Then pilot your campaign with small groups of employees. Strategize different ways to get people's attention; once you discover what works, you can expand your efforts. Think creatively: Include a booth at a benefits fair, or promote your roll-in campaign around National 401(k) Day. Give people opportunities to roll in on the spot through electronic tablets or old-fashioned paper. Reducing barriers to action can make it easier for employees to follow through with their intentions.

As you consider how to conduct your roll-in campaign, here are a few pointers for translating your strategy into tactics:

1. Understand record-keeper requirements.

To make the process smooth and efficient for employees, make sure that your record keeper supports your roll-in campaign. Ask your record keeper to describe the information needed to roll assets into your plan, and look for opportunities to streamline that information further. Also be sure the record keeper is prepared for the spike in roll-in volume that could occur

Continued on Page 17

ITOCK COMPOSITE

Focus should be lifetime income

Successful planning needs to emphasize retirement 'paycheck'

Guest Blog
Frank Porcelli

YOU'VE HEARD THE PLOT points: longer lives. the disappearance of traditional pension plans, and markets that may not deliver what investors need from them. As it stands now, the story ends up like this: Americans are distressingly unprepared for the realities of retirements that may last as long as 30 years.

What are we missing when it comes to retirement readiness? Over countless conversations with financial advisers, one answer keeps coming back: We haven't given investors an intuitive way to see their savings through the lens of the income they'll have each year in retirement — or an easy way to see how the choices they make can affect that income.

It's time to change the conversation — and the definition of successful retirement planning — to put the focus on retirement income. All of us need to lock arms on this important mission.

Once we do, we can face down the reality that retirement readiness is a problem for virtually everyone. Americans nearing retirement report nest eggs of just over $130,000, which translates into about $9,000 per year in annual income in retirement — $36,000 less than most of these investors say they'll need to live on, according to findings from BlackRock's recent Global Investor Pulse Survey.

So how did we get here? For decades, we've all been married to the concept of the lump sum — to accumulating as much wealth as possible. The nest egg is practically written into our DNA: Calculate a number. Save and invest to reach it. Retire.

But we tend to bury the ending, when a nest egg becomes a source of income — in other words, the "paycheck" we receive for the rest of our lives.

"We tend to bury the ending, when a nest egg becomes a source of income."

GETTY IMAGES

LUMP-SUM MINDSET

And even when we are thinking about retirement income, we often aren't equipped to tackle the thorniest questions. The lump-sum mindset eclipses crucial factors, like how to adjust for shifting income needs in different years or savings rates that can go up and down.

Most retirement investing strategies focus on market performance in the accumulation phase and then apply broad guidance (such as the 4% withdrawal "rule") on the spending side. That's "nest egg" thinking. What we really need is income thinking, along with capabilities for building portfolios and spending plans that map to our actual incomes and goals in retirement.

There are tools out there that will translate savings to income, but they use

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The roll-in solution

Continued from Page 16
if your campaign takes off.

2. Get buy-in from other stakeholders.

A successful campaign requires that your colleagues are on board. Get alignment and support from senior management to promote the campaign, and ask managers to spread the word in staff meetings. Manager meetings are a powerful forum that can help you deliver the kinds of individualized messages that employees are more likely to act upon.

3. Use communications strategies that work.

In your campaign materials, focus on the benefits of rolling in — particularly that doing so can help employees reduce stress and streamline their financial lives.

Orchestrating a roll-in campaign doesn't have to be an elaborate task. All you need is a good rollover form and a captive audience.

4. Try different approaches.

There isn't just one path to successful participant communications. Certain methods of communication might work better than others, so don't be afraid to experiment a little.

For example, you could send the same piece of information through internal communications and through your record keeper, then track results to see which method was most successful. You can use the data to inform future communications efforts.

Ultimately, rolling in is a simple step that stands to make participants' retirement savings easier to manage. If your campaign can help improve their retirement readiness, your participants will value you for it.

Megan Yost is head of DC participant engagement at State Street Global Advisors.

ISTOCK

Income

Continued from Page 16
backward-looking assumptions, and more importantly, don't reflect longevity risk.

Without that information, it's hard to get an accurate estimate of the true cost of retirement income, leaving too much to guesswork and raising the potential of a surplus — or, worse, a shortfall.

LASTING STRATEGIES

We need to partner to create retirement strategies that, with a fair degree of certainty, will generate the retirement income that clients want for as long as they need it.

Important steps toward this include:

• Changing the benchmark for success from short-term market performance to lifetime retirement income.

• Taking longevity risk off the table by monitoring how much it costs in today's dollars to produce future retirement income.

• Helping set a baseline for retirement income and translating that baseline into appropriate portfolios for clients.

• Setting clients up with a spending plan that accounts for actual life expectancies and adjusts as markets and other circumstances change.

This is no small task, but there's plenty of opportunity here too. Getting investors to think not just in terms of what they're putting away today but also about the income they'll need tomorrow helps advisers restart the retirement conversation, get on the same side of the table as their clients and get better insights into how to build portfolios that will deliver on their clients' goals.

By reframing the conversation to focus on retirement income, we truly believe we can help people better see what lies ahead and better prepare for the years ahead. Let's work together to make sure their stories turn out right.

Frank Porcelli is chairman of BlackRock's U.S. wealth advisory business.

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Are ETFs, 401(k)s a good fit?

Continued from Page 14
the other hand, can be purchased in fractional shares, which fits well with the way participants contribute to a retirement plan.

"The robo-adviser industry is helping a lot of this, because a lot of the robo technology is overwhelmingly ETF-based," said Chris Karam, chief investment officer at Sheridan Road Financial.

Although the 401(k) market tends to be slow to adopt new features, Steve Anderson, president of Schwab Retirement Plan Services, thinks the ETF concept will catch on.

The present-day market sentiment is similar to that in the late 1980s and early 1990s, when most plans were serviced by banks offering investment options with quarterly valuation and little transparency, Mr. Anderson said. Providers transitioned to daily valuation around that time, and mutual funds, which represented only 8% of 401(k) assets in 1989, grew to take a 45% share in a little over a decade.

Mutual funds made up $2.9 trillion, or 63%, of the total $4.6 trillion in 401(k) plans in 2014.

"When that happened there was a lot of noise from plan sponsors and consultants saying, 'Why do we need to create access on a daily basis to 401(k) plans?' There was a lot of push-back," Mr. Anderson said. "We see moving to ETFs as maybe the next step."

Some advisers also expect them to catch on.

"I think it will gain in popularity," Mr. Karam said. "I think you'll have advisers build their business models around something like this."

"It will take those advisers who are already committed to an all-ETF solution in their portfolio management philosophy and [would] apply that to a 401(k) plan sponsor," he said.

MAIN SELLING POINT

Supporters tout low cost as a main selling point. ETF economics are more compelling when looking at plans down-market, according to Nathan Voris, director of sponsor and workplace investment solutions at Morningstar Investment Management.

63%
Portion of the $4.6T in 401(k) assets in 2014 that's invested in mutual funds

The gap in fund expenses between large and small plans is wide. For example, in 2012, domestic equity mutual funds cost an average 95 basis points, on an asset-weighted basis, in 401(k) plans with less than $1 million. That dipped to 48 bps for plans with at least $1 billion, according to a joint ICI-BrightScope study published last year.

Schwab, which does record keeping for plans with more than $20 million, says its fund cost could be 10 bps or less. The firm offers approximately 80 index ETFs, both proprietary and non-proprietary, covering 26 asset categories.

Apparently, some big plans see the appeal, too. The largest 401(k) sponsor using Schwab's all-ETF product has $700 million in assets, and there are some others with more than $100 million, Mr. Anderson said.

He declined to say how many have signed on in total. Cerulli Associates data peg it at more than 120 plans.

Based on cost, advisers potentially can differentiate themselves from a fee perspective by using ETFs, Mr. Karam said.

However, detractors say some index mutual funds and collective funds are equally competitive pricewise, or perhaps even less expensive.

"The cost savings argument for ETFs is currently debatable," said Bridget Bearden, director of retirement research at Strategic Insight.

According to Morningstar data, passively managed open-end mutual funds have an average asset-weighted expense ratio of 8 bps for institutional shares, compared to 27 bps for a passive ETF. ETF expenses do beat passive A-share mutual funds, which average 68 bps.

> *"If we can have intraday pricing in a DC plan, I don't think that's a bad thing."*
> **Nathan Voris**
> Director
> Morningstar Investment Management

The average index mutual fund across all 401(k) plan sizes costs 13 bps on an asset-weighted basis, according to the ICI-BrightScope study. Costs range from 11 bps for plans with more than $500 million to 33 bps for plans with less than $1 million.

"If you want to offer cheap, passive investing in DC plans, there's access to do that," said Sam Campbell, director of research at Fuse Research Network. "So I think the ETF is much more of a marketing appeal, potentially, than bringing real benefits to the space."

Dan Egan, Betterment's director of behavioral finance and investments, thinks ETFs' fee transparency is the most compelling reason to use them in 401(k)s.

Whereas mutual funds can charge 12b-1 fees and pay revenue sharing to providers as a way to compensate them for plan expenses, ETFs can't do that from a structural standpoint, he said. These kinds of fees may be "hidden" from participants, Mr. Egan added.

BROADER EXPOSURE

While there's been a move toward more fee transparency in 401(k) plans, R-share mutual funds accomplish the same thing as ETFs in that regard, said Michelle Rappa, head of defined contribution investment only marketing at Neuberger Berman.

ETFs are often popular among retail investors as a way to get exposure to unique markets. That doesn't translate well to DC plans, which largely seek out broad exposure to traditional markets, Mr. Campbell said.

The 401(k) vehicle also negates many of the benefits ETFs provide in other settings, critics say.

For example, the tax-efficient nature of ETFs isn't an added value in 401(k)s, which are already tax-advantaged, according to Ms. Rappa. And the ability to trade in real time is contrary to the long-term nature of 401(k) accounts, others say.

"In a 401(k), are people really trying to nail the intraday price?" asked Joe Ready, director of Wells Fargo Institutional Retirement and Trust.

Mr. Voris disagrees. Access to data such as intraday pricing is one of the allures of ETFs for participants, he said.

"We live in an age of information. If we can have intraday pricing in a DC plan, I don't think that's a bad thing," he said. "If there's a participant that wants that information, it's available to them."

Schwab said 85% of participants in the ETF product are enrolled in a managed-account service offered through the platform, and those who participate that way can't do intraday trading.

Among the remaining participants, trading activity was slightly lower with ETFs than that seen with mutual funds across Schwab's other record-keeping platforms in 3Q — 14% vs. 16%, respectively, in terms of the number of participants executing a transaction.

PLATFORMS NOT READY

Betterment's platform requires that participants stay in a managed account, so they wouldn't be able to try timing the market, Mr. Egan said.

The majority of big record-keeping platforms are not structured for ETFs, and until that changes, ETFs probably won't gain much traction in the retirement space, Ms. Rappa said.

Nor do most record-keeping firms have much desire to invest in such a capability, which potentially could cannibalize their proprietary mutual fund business, some argue.

There are only a handful of other parties that have the ability to support ETFs in 401(k)s, namely a few clearing platforms such as SunGard and Matrix, Mr. Campbell said. Those firms don't have a bundled record-keeping platform like Schwab, for example, but RIAs and third-party administrators theoretically can build an ETF platform for plans that way, he added.

Ultimately, the use of an ETF platform comes down to a plan sponsor's philosophy and goals. The vehicle is much less important than the overall plan strategy, Mr. Voris said.

For example, ETFs might work well for a plan sponsor looking for broad market exposure across broad asset classes, Mr. Karam said.

However, Mr. Chambers said he advocates for a mix of active and passive management in 401(k) plans, which doesn't gel with all-passive ETF lineups. "I almost always recommend that they blend them together," he said.

Mr. Karam echoed that sentiment, saying that for those sponsors looking for the flexibility to use active and index funds, it would be difficult to mix and match on an all-ETF platform.

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THE C SUITE

MANAGEMENT INSIGHTS FROM TIM SCHEVE

Patience really is a virtue

By Liz Skinner

ADDISON GEARY

The young Timothy Scheve dreamed of being an architect, a profession that blended science with more creative passions. Trouble was, even after earning a college degree in the subject, he just wasn't any good at it.

Plan B was business school, and that's worked out well for Mr. Scheve, Janney Montgomery Scott's chief executive and president since 2007.

Janney is Mr. Scheve's first time out as the top corporate executive, but he took many lessons away from his time as chief operating officer at Legg Mason, working under chairman Raymond A. "Chip" Mason. One of those lessons: Senior leaders can't be friends with anyone.

He's also worked with a professional coach to make sure he doesn't come across too direct or overpowering, which, at 6 feet 7 inches tall, can be a challenge.

Mr. Scheve, 57, does his best thinking during his hour-long morning runs around Philadelphia, where the brokerage is headquartered.

Janney has about 740 advisers who manage a total of $67 billion in assets. They should all be warned: Don't copy Mr. Scheve on an email if you expect him to read it.

Liz Skinner: *How would you describe your leadership style?*

Tim Scheve: It's transparent and collaborative, and, for me, integrity is incredibly important. If you think about decision making, there are a lot of things that you can ignore and they'll solve themselves. A lot of time with leadership, there's a rush to action. Patience is a really important attribute; it's one I learned from Chip Mason. Patience was one of his great attributes, which is sort of unique for an entrepreneur. In a meeting with my staff, I'll always be the last to speak because if I come in and say I want the carpet to be blue, then for the most part I've ended the dialogue. I have learned that I have to hold back and let the dialogue develop.

LS: *Before getting your bachelor's and master's degrees in business from Brown University, you earned a B.A. in architecture. What happened with that pursuit?*

TS: I wanted to be an architect. Everyone in my family were engineers, physicists, very science-oriented, so I decided I wanted to be an architect because it's creative and yet still kind of science-like. I had never actually met an architect in my life. I went to Catholic University [which gave him a full scholarship] and I really liked all the people in the architecture program. But I realized I had absolutely no talent. The only thing I was good at was building science. Everything I designed looked like a shoe box, albeit very well built. Also, architects don't do anything until the last minute, which is so not me. I came up with Plan B: Go to Brown University. Brown really likes people with different backgrounds, so they liked that I was an architect who really wanted to be a business guy.

LS: *What kind of culture are you trying to foster at Janney Montgomery Scott?*

TS: We focus on clients; they have to be the center of everything we do. If our client interest is second to none, then integrity comes naturally. Integrity is so incredibly important in our business, and it's really important for a midsized firm. Big firms can take lots of hits on their integrity, smaller firms really can't.

LS: *What are some things you don't tolerate?*

TS: Dishonesty. The quickest way to end your career at Janney is to do something dishonest. Bad behavior is the second, bad behavior to colleagues or to your clients.

LS: *What qualities do you look for in a potential hire?*

TS: Hiring is hard. They have to have the requisite skill set, or if they don't, they have to have a unique skill set and a pattern of success. You also want to make sure they are resilient. We get knocked down a lot in life. I ask them about times when things didn't go as planned for them and how they adjusted to that. You don't want someone who has had unqualified success, because things are going to happen and you want to know how people will react to it. It's also about how they treat people out of the office. How do they treat a waiter? When a homeless person comes up to them in the city, how do they react? It's observing how they react and treat people.

LS: *Was there a time when you had to be resilient?*

TS: I started in this job in 2007 and then we had the financial crisis. That was a scary time. I knew we were fine and I knew our parent company [Penn Mutual Life Insurance Co.] was fine. But you're watching and every Sunday night we were talking about what message were we going to put out to our people about what's happening. That was about resiliency. When things are going really well as a leader, you have to ask the tough questions and make people uncomfortable. You want to make sure you're looking around the corner. When things are going really bad, you have to be the positive message. Not a Pollyannaish message, but strength and stability. It's about focus and keeping people grounded on what they can control as opposed to worrying about what they can't control.

LS: *What advice would you give to a chief operating officer who hopes to become a CEO?*

TS: It's about understanding how you grow the business. The one thing you learn in CEO school is that your expenses are going to grow by 3% to 4% no matter how hard you try. Rents are going to go up, salaries are going to go up, benefit costs are going to go up. So you have to grow your revenue by a multiple of that. You have to be innovative in how you grow that multiple and you have to be comfortable doing acquisitions, hiring talent and taking risks and trying new things.

LS: *Let's talk about time management. Do you do anything unusual?*

TS: It annoys a lot of people, but I almost never read emails that I am cc'd on. It tends to mean someone wants to infer that I'm involved, but it also might be something that I don't need to be involved in. Also, I don't like long meetings. I'm very structured. I wake up and go running at 5 a.m. so I can be in here by 7:30 a.m. — and I do that everywhere that I am in the world. I go out a lot to entertain, but I tend not to stay late. By 9 p.m. I'm leaving, for one because nothing good ever happens after 9 p.m. anyway, and I don't want to be part of it. It's also carving out time to think; that's where running helps. I run for an hour, so after you get the first mile or two down, you can start thinking about things and start clearing your head.

Visit InvestmentNews.com/csuite for a longer version of this interview.

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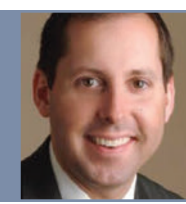

A window into the art of reframing

The most successful advisers have changed the way they approach the client relationship

The following is an excerpt from "You've Been Framed: How to Reframe Your Wealth Management Business and Renew Client Relationships" by Ray Sclafani (Wiley, 2015).

What is it that separates the highest-performing financial advisers from everyone else? Is it the ability to sell big? Is it awesome technical expertise? Is it uncanny insight into markets, or is it super-savvy people skills? All of these traits help the best performers rise to the top, but at the core of these advisers' success is ... the ability to innovate.

Top-performing advisers — or those whom I call the "best in the business" — can adjust on the fly. They shift, modify and improve as circumstances and contexts change, and they are improving all the time. These advisers are not afraid to reframe when needed; in fact, they know that they will fall behind, maybe even fail, if they don't.

THE BEST in the business don't want you to know that they're masters at adapting.

What the top-performing advisers don't want other advisers to know is that they are successful in the business because they are really good at adjusting. Right? No one wins because they insist on sticking with the game plan regardless of what they see happening on the playing field. The only way to win is to adjust, and the best in the business don't want you to know that they're masters at adapting to changing circumstances. What's more, they are also really good at empowering those around them — on their teams and in their firms — to adjust, too.

Another way to think of it is as a willingness to reframe. Reframing is really about getting a read on where your clients are today and making adjustments to give them the value they desire and deserve. It's about assessing the characteristics of today's world and refining your business to serve clients in this emerging context.

This business is about change. We've seen more change in the past few years than we've seen in the decade prior. Those who survive and thrive embrace the changes and make the appropriate shifts, adjustments and reframes required to succeed. Those who produce weaker results keep doing the same things over and over while expecting better results. But as Albert Einstein once said, that kind of behavior is the definition of insanity.

At ClientWise, my executive coaching company for financial leaders, we observe practice management and study leadership every day.

OBSERVATIONS

In our observations and analyses at ClientWise of the top-performing advisers, we have discovered that those who are most successful have reframed themselves for wealth management in the 21st century.

They have discovered that the old game plan no longer works and have engaged in five key reframes. These reframes have given them a distinct competitive advantage over others in the industry, allowing them to grow their practices into the most successful entities that they can be. The table below presents the five reframes — outlining the shifts from the old frames to the new frames — for effective wealth management practices in the 21st century.

In each of these five reframes, there is a pattern of partnership. Advisers can only provide comprehensive wealth management by partnering with others, internally and externally, to augment their own specialties and expertise (Reframe No. 1). Advisers also interact with clients using a partnering relationship rather than a sales-to-customer relationship (Reframe No. 2). In addition, advisers partner with team members to ensure the best service and outcomes are provided to clients (Reframe No. 3). What's more, advisers no longer tell clients what they should value; rather, advisers partner with clients to discover what clients need and value and then improve their own practices to provide that (Reframe No. 4). Last, advisers build a business that outlasts them by partnering with younger financial advisers whom they mentor and to whom they pass their wisdom (Reframe No. 5).

CULTURAL SHIFT

Today's high-performing advisers have recognized the cultural shift from hierarchy to equality and from authority to partnership. Whether it's the way the Internet has allowed consumer access to information — leveling the playing field between consumers and the professionals who serve them — or the emergence of the sharing economy, where people can bypass traditional corporations and turn directly or near directly to others for a car ride, room stay or grocery delivery, the world is now flatter than ever.

Translate this phenomenon to the world of financial advising and we start to see a shift from a vertical relationship to a more horizontal one. How does this look in practice? It's the adviser moving from behind the desk to sit beside clients. It's not an approach of, "I have all of the information and you need me." Instead, it's an approach of, "All of the information is in the public domain, and my job is to help you make sense of it and to remove the complexity associated with wealth management."

PREMISE OF PARTNERSHIP

High-performing advisers have recognized this shift from a hierarchical to a collaborative relationship, and they have made the reframes necessary to build their practices on this premise of partnership: adviser to client, but also adviser to internal and external teams as well.

The first secret of the most successful advisory firms is this: Financial advising is no longer just about offering one particular service such as investment advising, insurance or financial planning. It's about providing support across all the areas of wealth management that are essential to clients: investing, financial planning, financial management, financial reporting, risk management, family continuity, trusteeship and/or philanthropy.

Admittedly, since 2010 there has been a trend for advisers to move from calling themselves "financial advisers" and "financial consultants" to "wealth management advisers." Yet many have made the switch without actually adjusting or reframing the services they offer. These folks call themselves wealth management advisers, but they still focus solely or mainly on investments or whatever individual service they traditionally have offered.

In contrast, the best in the business understand that this evolution in title goes far beyond semantics. It offers an opportunity for the adviser to go wider and deeper than finances — beyond dollar signs in the bank account and stocks and bonds in the retirement fund — to serve the diverse areas that relate to a client's wealth. Think opportunity. The end result is that these particular firms are able to attract new clients interested in comprehensive support, to capture additional business from existing clients who need and want more, and to increase client retention as clients remain satisfied and find value in these firms' offerings.

At the core of this particular reframe is outcomes-based financial planning to deliver the comprehensive approach of wealth management. We must put financial planning at the core. The financial plan ensures that the adviser and client take everything wealth-related into account. For example, there will be no grossly overweighting one stock because you don't realize the client already has investments there, and you won't sell the client life insurance when he or she already has it.

THE BIG QUESTION

As David B. Armstrong, president and co-founder of Monument Wealth Management, notes, the financial plan answers the big question of what is the money for? As important of a question as that is, plenty of advisers and clients may not have taken the time to answer it. Yet understanding what the money one is making, saving, growing and managing is for ensures that advisers and clients know how to build the right type of wealth management plan. It also enables them to assess if they are achieving their goals and, if not, to make adjustments along the way.

Wealth management practice reframes for the 21st century

	OLD FRAME		NEW FRAME
Reframe #1	I provide my clients with one particular financial service.	➔	I provide my clients with comprehensive wealth management that begins with outcomes-based financial planning.
Reframe #2	I sell to my clients.	➔	I partner with my clients.
Reframe #3	I am the best at serving my clients.	➔	My team is the best at serving our clients.
Reframe #4	I know what is of value to my clients.	➔	My clients and my team work together to define what value our clients need and what value my team can provide.
Reframe #5	I allow clients to rent my services until I choose to stop practicing.	➔	I build a legacy business that serves multiple generations to come.

Where the adviser or firm does not have a skill set, partnerships with other respected professionals can be built. The best of the best do this skillfully. They learn about trusted professionals by going directly to clients to invite them to share their networks, and then they go about building a team of professional advocates that can be used again and again to offer clients a web of support. The adviser stays in the lead, making his or her advice and network indispensable to the client so that others in the network remain partners, rather than competitors. A new way of running the wealth management business takes shape, and everyone benefits in the process.

WHO'S AGENDA IS IT?

In a wealth management partnership, it's not about the adviser's agenda, but the client's agenda. As a result, the adviser uses his or her expertise to support the client and the client's goals at the same time that the client is brought more intimately into the relationship to be an active participant in meeting goals and creating financial success.

In the view of Geri Eisenman Pell, chief executive of Pell Wealth Partners, it's not that the sales piece is "bad" or has to be removed entirely from the equation, but there is a big difference between being a "product pusher" and someone who offers financial products to clients in service of a well-thought-out financial plan. As Ms. Pell puts it, "If you lead with financial planning and if you're always filling a need that a person has and never filling your need to sell a product, then ... there's no negative connotation to it." She explains, "I've never had anybody say to me, 'You're just selling this because it's a product you want to offload.' Never."

The best advisers recognize that the value of the profession is no longer to simply sell to — or even advise or consult with — the client, but instead to create this partnership. They know how to enter into an equal relationship with the client rather than defaulting to the more traditional one-way relationship that has characterized the profession for so long, in which the adviser is the authority and the client is merely the recipient of advice and technical expertise.

The change in the industry from an approach of "sales-driven by the adviser" to "partnership-driven in service of the client" follows the natural evolution seen in other industries. There we see the relationship between expert and consumer has shifted from a vertical one to a horizontal one as the Internet has given people access to everything, from information to products and services, and has empowered them to step into the role of equal in many areas. In health care, patients now have easy access to online medical advice and their medical records, empowering them to ask doctors more questions and self-report more information to improve their care. In the financial industry, clients can now manage their own portfolios through online accounts, and they have access to the latest financial news, allowing them to be more educated in conversations with their advisers and to make more informed requests.

As clients have become empowered by access to information, they also have developed an expectation that they will be treated as partners in all of their important relationships. They expect their relationship with their financial adviser to be no different. The best in the business recognize this and actively work to create healthy partnerships with clients.

As Ms. Pell points out, all too often firms fall into the trap of thinking that investing for their clients and reporting back to them on those investments is enough. In fact, clients need an in-tune, agile adviser who can detect clients' unique financial concerns and respond to them in a satisfactory way. That's partnership. She recounts a telling story on the subject, in which she met an ultrahigh-net-worth woman at a charity event who confessed that the brokerage firm that served her and her husband was missing the mark at hearing and responding to their concerns.

FINANCIAL ADVISING is no longer just about offering one particular service such as investment advising ... or financial planning.

The husband had some serious financial concerns that were keeping him up at night. Although "the blue shirts" of the firm, as the woman called them, agreed to meet with the couple, the conversation centered around technical jargon that did nothing to put the couple at ease. As a result, the husband continued to suffer from insomnia due to his ineffectively allayed financial concerns. A firm skilled in partnership would have caught their true concerns through active listening and worked through them in dialogue and follow-up action with the clients.

ADVISER AS COLLABORATOR

In addition to being what clients want today, partnership is also what clients need today, and the best advisers are recognizing this. Clients are busier than ever; they are flooded daily with data and communications to process and manage, and the varying elements of their wealth picture have become more complex. Today's client welcomes the support of a wealth management partner who is attentive to the whole wealth picture and willing to engage with the client as a collaborator.

The best in the business see these opportunities and engage.

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47 House Democrats ask DOL to open final rule for comment

Some Capitol Hill Democrats are torn between President Barack Obama and the financial industry over a Department of Labor proposal that would change investment advice standards for retirement accounts.

In an Oct. 30 letter to DOL, 47 House Democrats called on the agency to open a 15- to 30-day comment period after a final rule is promulgated, likely early next year. They assure the DOL that such an accommodation can be made "without disrupting your intended timeline of implementing the rule by the end of 2016."

The extra comment period would slow down the rule though, as the Obama administration tries to get it in the books before it leaves town in early 2017. Tapping the brakes is something the financial industry wants to do, and now it has nearly four dozen Democrats echoing its stance.

This latest letter is much more of a threat to the DOL rule than previous letters from Democrats. One that was signed by 96 House Democrats called for specific changes in the rule. That call coincided with the agency's promise it would listen to feedback and make changes.

The Oct. 30 letter is an example of Democrats bending over backward to help the financial industry without directly opposing the rule, which Mr. Obama strongly supports.

All but three House Democrats recently voted against a bill that would have halted the DOL rule. But now Rep. Jared Polis, D-Colo., who gave a floor speech in opposition to that bill, has taken the lead on the Oct. 30 letter. The industry didn't get a vote. But it did get a letter.

"It's either unbelievably naïve to think [another comment period] doesn't disrupt the process or something much more cynical is going on here," said Barbara Roper, director of investor protection at the Consumer Federation of America.

SAY FEEDBACK IS NEEDED

The House Democrats who signed the letter say the DOL should get feedback on any modifications it makes to the rule.

"You would then be able to make final changes based on this short comment period, and presumably finalize the rule," wrote Mr. Polis and 46 of his Democratic colleagues.

Mr. Polis and many of the Democrats who signed the letter list "securities and investment" or "insurance" or both among their top five industry donors for the 2016 election, according to the Center for Responsive Politics.

The Securities Industry and Financial Markets Association and the Investment Company Institute have each made campaign donations to 12 of the Democrats signing the letter. The Financial Services Institute, which has a much smaller political action committee, has donated to two of them.

The language of the letter repeats industry concerns about "unintended consequences" of the rule for "low- and middle-income American families" seeking financial advice.

Of course, on the other side, interest groups with a lot of money to spend on campaigns (e.g., AARP) are lobbying lawmakers, too.

There's nothing illegal, unethical or immoral about taking campaign contributions from the financial industry or consumer groups and then listening to their policy concerns. Such activity, in fact, is constitutionally protected — and creates a cacophony on Capitol Hill.

"What we need is the DOL to take the time and get the rule right," Dale Brown, FSI president and chief executive, said on the sidelines of an FSI conference in Washington on Tuesday. "Every voice helps."

The extra comment time would come on top of two comment periods that have been conducted since the rule was proposed in April. Those solicitations drew more than 3,500 letters. The agency also conducted four days of hearings on the rule in August.

The DOL declined to comment on the letter.

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New Riskalyze tool links its 3 services

By Alessandra Malito

Riskalyze, the company that offers risk assessment and alignment with client portfolios, has created a wealth management dashboard that links the company's three services: risk, a robo-adviser and compliance.

The Real-Time Wealth Management Enterprise is designed to solve four problems that Aaron Klein, chief executive of Riskalyze, said he hears from advisers. They include how to manage fiduciary reviews of client portfolios once the Labor Department's fiduciary rule passes, how to propose portfolio changes in response to those reviews, drive scalability by working on smaller accounts and have the process happen immediately. There are no additional costs for the adviser to use the system, and implementation will take about 75 days for most customers, Mr. Klein said.

It is particularly helpful for smaller accounts, which can be found on Autopilot, the company's robo-adviser, Mr. Klein said.

"What is beginning to emerge is a way to use technology to provide a good level of service to those smaller accounts," he said.

THE NUMBER IS UP

Advisers logging onto the platform will already see the Riskalyze number, the score summing up a client's risk tolerance threshold with his or her portfolio. Upon fiduciary reviews on client accounts, advisers can see if a portfolio must be changed, immediately make those changes and then send it off to compliance in a few clicks for approval.

It all comes down to the potential DOL effort to require advisers to act in their clients' best interests when it comes to their retirement accounts.

"We have sort of pioneered the risk-first investing approach," Mr. Klein said. "We are uniquely capable of helping advisers document that they are exercising fiduciary duty under DOL rules."

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Gross fund loses Soros' $500M

Bloomberg News

George Soros's firm pulled almost $500 million from an account run by Bill Gross, money it invested last year after the bond manager left Pacific Investment Management Co. to run a new fund at Janus Capital Group Inc., according to a person familiar with the matter.

Data from eVestment show that an unidentified institutional investor redeemed $490.1 million from the global unconstrained bond strategy run by Mr. Gross at Janus, sister publication Pensions & Investments reported. The money was pulled by Soros Fund Management, the firm overseeing the wealth of the billionaire investor, said the person, who asked not to be identified.

The redemption is a setback for Mr. Gross, who has struggled to attract assets at his $1.38 billion Janus Global Unconstrained Bond Fund amid mediocre returns. It has declined 1.2% this year, trailing 71% of similar funds, according to data compiled by Bloomberg.

Officials for the Soros firm, Janus and eVestment declined to comment. The Wall Street Journal reported last Monday that the Soros firm was the unidentified investor.

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Fixed indexed annuity sales gaining on VAs': Cerulli

By Greg Iacurci

Fixed indexed annuity sales are steadily gaining on those of variable annuities, thanks in large part to continued low interest rates.

"We do see fixed indexed sales growing faster than traditional variable annuity sales," said Bing Waldert, a director at research firm Cerulli Associates Inc.

Although VA sales are almost triple those of fixed indexed annuity sales, the gap has narrowed over the past several years. According to Cerulli's ninth annual annuities and insurance report, total flows to VA products were $138 billion in 2014, an 11.5% drop from $156 billion in 2011.

Fixed indexed annuities, on the other hand, saw $48 billion in flows in 2014, a surge of 45.5% from $33 billion in 2011. Flows to fixed indexed annuities grew every year from 2011 to 2014, while flows to VAs declined each year over that period.

SECOND-BEST QUARTER

Wirehouses and independent broker-dealers propelled fixed indexed annuities to their second-best sales quarter of all time in the second quarter of 2015, when the annuity products notched $12.6 billion in total sales. Variable annuities had $35.6 billion in total sales in the second quarter, according to the Insurance Retirement Institute.

$48B Net flows into fixed indexed annuities in 2014

"We're projecting [fixed indexed annuities] will continue to eat away at VA sales, especially traditional VAs sold with living benefits and guarantees," Mr. Waldert said.

Low interest rates are causing some advisers to turn to fixed indexed annuities to generate retirement income for their clients.

Traditional fixed-income instruments, whether individual bonds or bond mutual funds, currently offer income lower than traditional levels due to low rates; at the same time, VA products have come under pressure due to low rates, and products offered today in some cases aren't as "rich" or "attractive" as they were around four to five years ago, Mr. Waldert said.

Fixed indexed annuities, which are pegged to a specific index such as the S&P 500, provide a guaranteed minimum rate of return as well as the possibility for contract growth in strong markets, up to a certain maximum rate of return.

Insurance executives speaking at IRI's annual conference in September also cited interest rates as contributing factor in the growth of fixed indexed annuities. Investors are seeking certainty in an uncertain rate environment, they said, making a locked-in minimum contract return desirable.

"People want predictability," said John Kennedy, head of retirement solutions distribution for Lincoln Financial Distributors.

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Year-end tax planning strategies advisers should be considering

With less than two months remaining in 2015, taxes are top of mind

By Greg Iacurci

With the new year on the horizon, it's time for end-of-year tax considerations.

Because tax rules are largely unchanged, tactics employed last year will more than likely still be relevant. Still, there are important strategies advisers should keep in mind to help minimize clients' tax burden going into the last two months of the year.

"This has been an incredibly quiet few years with tax law, so there's not a whole lot different this year from last year," Tim Steffen, director of financial planning for Robert W. Baird & Co.'s Private Wealth Management group, said. "All the strategies you implemented last year should probably be appropriate this year."

INCOME SPIKE

For clients who saw a big spike in income this year due to a financial windfall such as a business sale, initial public offering or financial portfolio that's seen a lot of appreciation, there are a few strategies advisers recommend.

Donor-advised funds, for example, are a vehicle advisers can tap for charitable contributions. These funds allow clients to front-load charitable contributions into one calendar year, but pay out that money over time.

Clients therefore realize the full benefit of a tax deduction in the current calendar year, which could be helpful if there was a spike in income in 2015, according to Mr. Steffen.

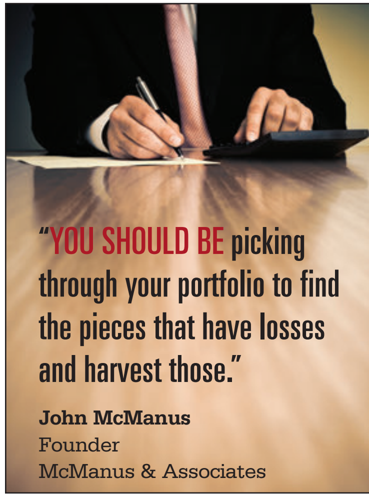
State tax credits for film production or low income housing are worth considering in the event a client has a larger-than-usual tax bill.

"I find that they are more popular with our clients these days when they have a liquidity event," said Charlie Douglas, a financial adviser and editor of the Journal of Estate and Tax Planning. The credits can help offset and reduce state tax liability if it's been a high-income year and a client can't defer income, he added.

Clients can get a tax credit through film tax partnerships, which are set up in the private industry but recognized by the state under the tax code to encourage film production in the state. Clients can reduce their state tax burden by paying money under a reduced tax rate to support these film partnerships.

Rather than pay, say, $1 in state taxes, a client may be able to pay a reduced rate of 90 cents, for example, for a film tax credit. "Rather than give the state of Georgia one dollar, I'd rather give 'Dirty Harry 16' 90 cents. It's a way to help reduce tax liability," Mr. Douglas said.

These credits vary from state to state, and there's more of a benefit in states with higher tax burdens, Mr. Douglas said. For example, the credits wouldn't make sense in Florida, which has no state income tax.



"YOU SHOULD BE picking through your portfolio to find the pieces that have losses and harvest those."
John McManus
Founder
McManus & Associates

ISTOCK

Financial markets haven't been particularly strong this year, which provides an opportunity for advisers to do tax-loss harvesting, according to John McManus, founder of McManus & Associates.

Tax-loss harvesting involves selling assets that have incurred losses in taxable accounts to offset taxes due to gains elsewhere in the portfolio. It's a strategy advisers especially turned to following recent bouts of market volatility.

"Given the markets have been flat, for sure you should be picking through your portfolio to find the pieces that have losses and harvest those," Mr. McManus said.

Through Nov. 2, the S&P 500 index was up about 2.2% for the year.

Market performance this year also creates a tax opportunity from an estate-planning standpoint, Mr. McManus said. For example, there's a federal tax exemption for assets of up to $5.43 million, and anywhere from $675,000 to $5 million at the state level, when transferred upon death. For assets beyond these thresholds, tax rates are 40% and roughly 10%, respectively, he said.

However, clients can essentially accelerate the exemption by establishing a trust during their lifetime, forfeiting the exemption they would have gotten at death.

"This year, since the markets are flat, we're poised to probably see some [market] growth going forward, so give the assets [to the trust] before the growth takes place," Mr. McManus said. That way, there wouldn't be any estate taxes on gains in the trust.

HIGHEST BRACKET

Taxable trusts are taxed at a rate in the highest bracket and are subject to a 3.8% Medicare surcharge tax if they have more than $12,300 this year in undistributed income, according to Mr. Douglas. Comparatively, for individuals to be placed in the highest bracket, 39.6%, they need to have household income of $413,200; $464,850 for married couples.

"That's kind of eye-catching," Mr. Douglas said, referring to the disparity. "I think a lot of financial advisers have clients that would have a trust, so it's worth sitting down with clients and talking about the tax efficiency of it, and possibly making some distributions from it by year-end."

The strategy, then, would be to get the trust's undistributed income below that tax threshold.

So if it's consistent with the objectives of the trust, clients can distribute some of the trust's income to children who are in a lower tax bracket, thereby getting the trust below the $12,300 income threshold and avoiding the Medicare surcharge and the 39.6% tax rate for the highest bracket.

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Putnam Retail Management

InvestmentNews readers weigh in on top stories

Readers have plenty to say about new Social Security reforms

InvestmentNews' coverage of the changes in Social Security claiming strategies provoked a lot of comments from readers. Some cried foul because the reforms, which will end file-and-suspend and filing for a restricted claim of spousal benefits, were sprung on the public without notice as part of a last-minute budget deal by Congress and President Barack Obama. And at least one reader claimed the elimination of the claiming strategies was probably the media's fault to begin with for writing so many articles alerting advisers about their existence.

"I'm not against moving toward closing unintentional loopholes on programs/rules that were designed to accomplish a particular strategy or goal, but this is nothing short of politicians racing the debt ceiling tick-tock-what-can we-knock clock! This is another not-very-well-thought-out decision."

— Stephen Niple

"If people are going to run into spending problems because of this rule change — and it is a noteworthy rule change — then their plan wasn't on strong footing to begin with. I don't know how many people who are eligible to collect Social Security benefits are actually filing and suspending, or using the restricting strategies. I contend it is a very small figure of the beneficiaries eligible. These strategies have only become popular in the past few years."

— Jack Riashi Jr.

"Well, I am not rich but a divorced 61½-year-old woman working three part-time jobs. I paid into the system all my life as a part-time worker and stay-at-home mom. Now trying to rebuild my life. I had depended on collecting my spousal benefit at age 66, continue working until 70 and then collecting my own at 70. My life expectancy is 90, so having a higher benefit makes all the difference in the world between being able to provide for myself or not. Many divorced lower-income women will be affected by this change. Don't take benefits away from women!"

— Rebecca Mudd Lewis

"A) It was targeted last year by Obama. B) It was passed by the Republican Congress. C) One of the most important rules in Social Security is, 'The rules can change.'
It seems to be a pretty nonpartisan issue. I was hoping to get spousal benefits only but can't really complain it is not fair — I still get what I paid. What is unfair is the people screaming that, 'It's my money, I paid it and I deserve it,' when, in fact, someone else paid it."

— Shawn

"We all want the tax loopholes closed unless it is my tax loophole being closed."

— Johnny Too Bad

"How can they make a fundamental change like this without even holding hearings on the issue? A disgrace. Write to your feckless congressmen."

— maynardGkeynes

"When financial journalists pound the table, give seminars for advisers, and run repeated articles in journals such as *InvestmentNews*, Congress is likely to note the "revenue expenditure" and take measures to claw it back. Mary Beth Franklin and other financial journalists did their job too well!"

— Lloyd D. Raines

To read our coverage on this topic and leave your own comments, go to InvestmentNews.com/socialsecuritychanges.

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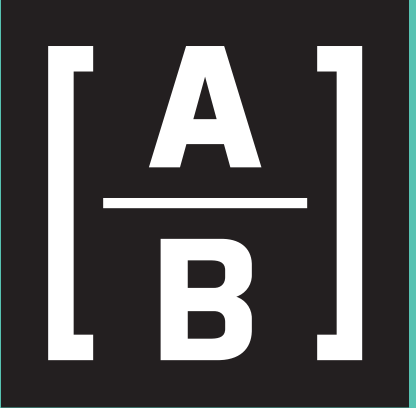

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Against 316 World Bond Funds

Intermediate Bond Portfolio (ABQYX)

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MUNICIPALS

High Income Municipal Portfolio (ABTYX)

Against 160 High Yield Muni Funds

National Portfolio (ALTVX)

Against 277 Muni National Interm Funds

California Portfolio (ALCVX)

Against 68 Muni California Intermediate Funds

New York Portfolio (ALNVX)

Against 49 Muni New York Intermediate Funds

Intermediate Diversified Municipal Portfolio (AIDYX)

Against 187 Muni National Short Funds

ALTERNATIVES

Global Real Estate Investment Fund (ARSYX)

Against 192 Global Real Estate Funds

Unconstrained Bond Fund (AGSIX)

Against 240 Nontraditional Bond Funds

EQUITIES

Core Opportunities Fund (ADGYX)
Against 1,519 Large Growth Funds

Large Cap Growth Fund (APGYX)
Against 1,519 Large Growth Funds

Concentrated Growth Fund (WPSGX)
Against 1,519 Large Growth Funds

Growth Fund (AGRYX)
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* Funds with track records under three years are not rated by Morningstar

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	MORNINGSTAR CATEGORY	3-YEAR	5-YEAR	10-YEAR
High Income Fund	Multisector Bond	5 stars among 225 Funds	5 stars among 169 Funds	N/A
Bond Inflation Strategy	Inflation-Protected Bond	5 stars among 196 Funds	4 stars among 174 Funds	N/A
Global Bond Fund	World Bond	4 stars among 316 Funds	4 stars among 236 Funds	4 stars among 137 Funds
Intermediate Bond Portfolio	Intermediate-Term Bond	4 stars among 945 Funds	4 stars among 831 Funds	4 stars among 589 Funds
High Income Municipal Portfolio	High Yield Muni	5 stars among 160 Funds	5 stars among 151 Funds	N/A
National Portfolio	Muni National Interm	5 stars among 277 Funds	5 stars among 233 Funds	5 stars among 162 Funds
California Portfolio	Muni California Intermediate	5 stars among 68 Funds	5 stars among 67 Funds	5 stars among 53 Funds
New York Portfolio	Muni New York Intermediate	5 stars among 49 Funds	5 stars among 49 Funds	5 stars among 40 Funds
Intermediate Diversified Municipal Portfolio	Muni National Short	5 stars among 187 Funds	5 stars among 172 Funds	5 stars among 120 Funds
Core Opportunities Fund	Large Growth	4 stars among 1,519 Funds	5 stars among 1,339 Funds	4 stars among 929 Funds
Large Cap Growth Fund	Large Growth	5 stars among 1,519 Funds	5 stars among 1,339 Funds	5 stars among 929 Funds
Concentrated Growth Fund	Large Growth	4 stars among 1,519 Funds	4 stars among 1,339 Funds	3 stars among 929 Funds
Growth Fund	Large Growth	4 stars among 1,519 Funds	4 stars among 1,339 Funds	3 stars among 929 Funds
Growth and Income Fund	Large Value	4 stars among 1,211 Fund	5 stars among 1,071 Funds	4 stars among 744 Funds
Small Cap Growth Portfolio	Small Growth	2 stars among 653 Funds	4 stars among 579 Funds	4 stars among 408 Funds
Global Real Estate Investment Fund	Global Real Estate	4 stars among 192 Funds	4 stars among 154 Funds	3 stars among 48 Funds
Unconstrained Bond Fund	Nontraditional Bond	3 stars among 240 Funds	4 stars among 144 Funds	4 stars among 49 Funds

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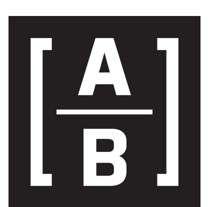

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Tech-savvy advisers are more successful: study

Tools are helping them increase business, reach younger clients

By Alessandra Malito

Advisers who take advantage of technology tools — anything from video conferencing software to all the features of a customer relationship management program — have bigger books of business and a more expansive reach to multigenerational clients, a Fidelity Investments study found.

Those advisers, whom the study referred to as eAdvisers, had almost 40% more assets under management and were pairing up with more Generation X and Y clients.

"Advisers are realizing how important technology is becoming and really permeating all different types of work in the office," said Tricia Haskins, vice president of practice management and consulting at Fidelity Clearing and Custody.

SIX CATEGORIES

There were six key categories of technology usage that eAdvisers excelled at, including reaching out to clients and prospects through social media, emails and text messages and using tablets and mobile devices to work with clients. About 75% of these advisers used tablets to view client information, compared with 23% of advisers not included in this category.

75% Portion of eAdvisers using tablets to view client information

Automated workflows with e-signatures and other software were another component of the study findings — 80% of eAdvisers said they use streamlined technology, compared with 24% of their less technically savvy peers.

Showing their clients their whole financial pictures was on the list, including data aggregation and interactive reports; 81% of eAdvisers provide this type of platform for their clients, compared with 47% of the rest of the advisers in the study.

Eight in 10 eAdvisers use software to track client interactions, as opposed to less than half of typical advisers.

ONLINE ACCESS

Ms. Haskins said that one of the biggest areas for advisers to excel in, however, was giving clients access to their information online. Almost all eAdvisers did this with electronic statements and reports, versus 72% of typical advisers.

She said some advisers may not use many technology tools because they can be too much to handle.

"There are different types of systems, and also a number of different solutions within those categories, so sorting through it all is a challenge," Ms. Haskins said. "As an adviser ... that can be overwhelming."

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Prep clients for big capital gains smack

Solutions aggregate fund distribution estimates

It's getting to be the time of year when mutual funds distribute capital gains to their shareholders. In most years, this "phantom income" is not material. Also, in most years client portfolios have appreciated, so the additional taxable income recognition is not terribly painful.

This year is different. Many portfolios have declined in value and, because of higher-than-normal fund liquidations, capital gain distributions are high. For example, the Oppenheimer Capital Appreciation Fund is estimating its year-end distributions at 13.07% of net asset value. T. Rowe Price funds have estimated distributions ranging up to 15% of NAV, and Dreyfus funds are estimating as high as 20% to 25% of NAV.

THE FIRST step to avoiding big distributions for clients is determining what they are.

BE PROACTIVE

How will your clients feel if they get hit with a big tax bill after a year of dismal performance? As an adviser, you have an opportunity to be proactive. At a minimum, you should warn your clients of what to expect. And if you want to be a hero, you can take steps to avoid these distributions. Absent automation, this can be cumbersome. The process is:

1. Determine which funds estimate high capital gain distributions.
2. Select an alternate mutual fund or exchange-traded fund to substitute for the high-distributing fund prior to posting.
3. Determine which clients hold material positions in the high-distributing fund.
4. Sell and replace shares of the high-distributing fund in cases where the savings is material. This necessitates determining the savings from lowering the dividend recognition net of potential recognition of gains (or losses) on the sales.

Without automation, the best an adviser can do is to warn clients and address the largest bombshells. However, to do that, the adviser first must find out the estimated dividend distribution amounts. Unfortunately, there is no central automated database for this information. But there are tools. At the most basic level, advisers can research each fund company's estimates for their clients' holdings. This will involve searching each company's website.

GAINS DATABASE

A better solution is the CapGainsValet site. Managed by Mark Wilson, this resource offers an easy way to search fund distributions in one place. There is no charge for using the site; Mark only asks users to make a donation to JDRF (formerly the Juvenile Diabetes Research Foundation).

BlackRock/iShares maintains a database of over 7,000 funds that is updated continuously as year-end distributions are announced. Advisers can simply provide BlackRock a list of tickers and the firm will send periodic updates as the estimates come out. This service is combined with a BlackRock marketing opportunity: They include information on a suggested ETF for each fund, should the adviser want to opt for their product to maintain market exposure.

Although the tools for dealing with capital gain distributions are fairly low tech, advisers need to work with what's available and not let this year's distributions wreak havoc for their clients.

Sheryl Rowling is the chief executive of Total Rebalance Expert and principal at Rowling & Associates. She considers herself a non-techie user of technology.

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THINKSTOCK

Finra urged to slow proposal for merger

Rule change would reintegrate arbitration arm

By Mark Schoeff Jr.

Plaintiff's attorneys representing investors are calling on Finra to slow down a proposal that would bring its dispute resolution arm back in house.

The Public Investors Arbitration Bar Association said that the industry-funded broker-dealer regulator has not provided enough time to comment on the rule, which would reintegrate the now independent Finra Dispute Resolution Inc. with the organization's regulation subsidiary, Finra Regulation Inc.

The Financial Industry Regulatory Authority Inc. filed the proposal with the Securities and Exchange Commission on Sept. 29. The regulatory notice was published in the Federal Register on Oct. 13 with a comment deadline of last Tuesday.

The SEC is scheduled to decide whether to approve the proposal by Nov. 27.

The measure would reverse a move in 1999 to separate the dispute resolution function into a separate subsidiary in order to strengthen the perception of the independence, neutrality and credibility of Finra's 6,476 arbitrators who hear customer and broker disputes against financial firms.

'COMPLETE ABOUT-FACE'

"The proposed reintegration is a complete about-face," PIABA president Hugh Berkson said. "We see a lot of buzzwords and catch phrases [in the proposal], but no detail. This was meant to fly under the radar. We can't study it the way it needs to be studied."

A SEC representative did not immediately respond to a question about the timing of the comment period.

A Finra spokeswoman said the organization is taking public feedback in a way consistent with previous proposals.

"Our rule making process is very transparent and the comment period for this rule was handled no differently than what it has been for other rules," Michelle Ong said.

In the proposal, Finra argued that the merger would "reduce unnecessary administrative burdens" because the two arms — arbitration and regulation — share many of the same resources. It also would formalize on the corporate organizational chart what investors already think — that Finra is one entity.

"From the public's perspective, Finra Inc., Finra Regulation and Finra Dispute Resolution have the appearance of a single organization," the proposal states. "Operationally, the three corporate entities largely function as a single organization."

> "THIS WAS meant to fly under the radar. We can't study it the way it needs to be studied,"
>
> **Hugh Berkson**
> President
> PIABA

FAIRNESS A QUESTION

But that's the problem, according to Mr. Berkson. PIABA has raised many concerns about the fairness of the Finra arbitration process.

If the merger is approved, defense lawyers may be able to point to a regulatory move that Finra has made — such as issuing a no-action letter — to argue that the firm is innocent of a claim.

A lawyer could assert that Finra "has decided there's nothing to pursue," Mr. Berkson said. "That is a concern."

A former Finra official agreed with PIABA that more time should be taken to consider the rule change, but he supported the substance of what Finra is doing.

Finra's arbitration and regulation arms have the same board, said George Friedman, who was director of Finra arbitration from 1998-2013.

"As a practical matter, I think the rule change is meant to reflect the situation as it has been on the ground for many years," Mr. Friedman said.

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Two types of planning crucial when transitioning your firm

Founders need to put in place plans for both succession and continuity

Succession planning is a critical yet woefully neglected business necessity that could cost advisers millions of dollars if not properly handled.

Depending on what survey you read, as few as 1 in 5 financial advisers have a binding and credible succession plan in place. The lack of one could cost you and your heirs millions of lost dollars and is a disservice (and some would say a fiduciary breach) to your clients.

Ask yourself, if you die tomorrow, will you feel good about how well your clients will be taken care of and how well your heirs will be compensated?

The question requires making an important distinction between succession planning and continuity planning. Succession planning is a well-thought-out, intentional plan to transition management and ownership of your firm to someone else. Continuity planning is having a plan in place to deal with a sudden disaster that threatens the immediate functioning of your business — like you getting hit by the proverbial bus.

The two types of plans go hand in hand and you need both.

To learn more about how to effectively implement a succession plan, I recently completed a podcast interview with Tim Kochis, the former chief executive of Aspiriant, and one with Jay Hummel, a corporate-strategy executive at Envestnet. Mr. Kochis and Mr. Hummel, along with Eric Hehman, are co-authors of a new book on succession planning titled "Success and Succession" (Wiley, 2015).

Mr. Kochis co-founded Kochis Fitz, a multibillion-dollar RIA firm known today as Aspiriant, and effectively transitioned himself out of the firm after a legendary four-decade career. Mr. Hummel, the former president of an RIA, now leads the corporate strategy group at Envestnet.

Here are seven insights from those conversations that can help financial advisers effectively implement a succession plan.

1. Like goals, you have to put your succession plan in writing.

"You don't really have a succession plan unless you've written it down and you've made it public," Mr. Kochis said. Putting it on paper makes it more likely you will measure performance against it and "makes it more likely you will give other people a stake in making it happen."

According to the book, a written succession plan should take into consideration the following:

• A clear understanding of what you are trying to achieve, what your firm values and what you stand for.

• How you will create a firm without "founder dependency."

• The form of governance and control, which is consistent with how the firm must operate to best serve clients.

• How you will transition the equity of the firm to properly reward the founder while still leaving enough future upside for the successor.

2. Emotions are often the biggest hurdle to overcome in starting a succession plan — but there are strategies to deal with them.

Stepping away from a business you founded can be tough. However, developing a succession plan actually puts you in control of how it happens and allows you to "do yourself, your staff and, most importantly, your clients a big favor by putting a plan in place to ensure the continuity of the firm," Mr. Kochis said.

3. Founders and successors have very different views on "risk" and they'd each be wise to understand the other's point of view.

Founders feel they took a huge risk to start their business. They may not have made any money for a while, may have lived off a spouse's income, and put in long hours for little pay. But, as Mr. Hummel pointed out, they usually didn't have a big cash outlay to start the firm and they called all the shots.

ISTOCK

By contrast, successors who are buying into a thriving firm have to pay a substantial amount of money for what is frequently a minority interest in an illiquid asset. Often, they have to take out a second mortgage, make debt payments, and still be subject to the governance structure of a firm that may be founder-centric.

VIEWS OF RISK

This difference in the view of risk between founders and successors "is a major issue," Mr. Hummel said. One solution is to step into the shoes of the other person. How would you feel? Can you see that person's point of view? Can you find the merit in their side of the equation? A little empathy goes a long way here.

4. Determine which of the three main types of succession strategies makes the most sense for your business.

You can sell your business, merge it with another, or develop an internal succession plan. If you have no plan for any of those, then by default you are heading toward running it into the ground while you die with your boots on.

No matter which route you choose, start today to make your business more attractive by systematizing business development and client service and make the firm less reliant on you.

5. Start today to pull the levers that will raise the valuation of your firm.

Several factors affect the value of your firm. Key among them are: the durability and growth rate of your client base, cash flow and profitability, and the status of key risks including the level of dependency on the founder, the quality of the management team, and the consistency and scalability of the client service and investment management models.

In other words, all the factors that would make a non-financial advisory business highly valuable apply here too. One key step you can take is to implement a rigorous strategic planning process and address issues holding back your valuation.

6. The successor who takes over from a founder will likely have a very different skill set.

Founders are entrepreneurs. They figure out what has to be done to get a business off the ground and they do it. They're business starters. They make it rain. But once the business is running, they're often times not the best person to manage it.

By contrast, successors are stepping into an existing business and they often have a "management" skill set. They know how to run the business but they're not necessarily big rain makers.

Mr. Hummel said one frustration of many founders is they want a successor who can manage the business and bring in new clients. "If I was running a firm as a founder today," he said, "I would understand that my succession has to be a team, it's not just going to be one person."

7. Never forget "the prime motivator" when transitioning ownership and management of your firm.

Mr. Kochis said if your goal is to maximize your personal wealth in a transaction, then "dial the business up and sell it to some relatively naïve cash buyer." He's not a fan of that idea.

He said the prime motivator should be "what's best for the clients."

While that objective might make the resulting strategy "more complex," he said, "if you do the right thing for the client, chances are very good that you're going to end up doing the right thing for yourself as well."

Steve Sanduski is president of Belay Advisor. Follow him on Twitter @SteveSanduski.

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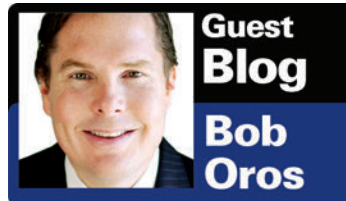
Breakaway growth as hopped up as the frothy craft beer industry

The number of large teams breaking away and starting their own independent advisory firms has been rising. Scott Highmark of Mosaic Family Wealth likes to compare this trend to the growth of the craft beer industry. Craft beers, like breakaways, have been around for years but recently there's been a notable increase in their appeal. Why?

Mr. Highmark, who recently broke away with a team of experienced investment managers to create St. Louis-based Mosaic, says it's because the marketplace is now primed for these models. I couldn't agree more.

Tastes are changing. Back in the day, industry giants reigned unchallenged — they didn't have to think much about innovating or refining their products. In contrast, today's entrepreneurs build from a deep base of knowledge and experience to customize their offerings. New technology and resources enable them to reach bigger markets and sophisticated customers seeking diverse, personalized experiences.

Mr. Highmark is onto something with this analogy, and he's onto something with Mosaic. I'd say that both the beer industry and the independent advice space are ripe for new models due to transformative changes in three areas: knowledge, value and experience.



BUILDING ON LESSONS

From brewing to marketing, craft brewers have learned from the artisans who came before them. Meanwhile, beer drinkers have become far more discerning. They're on the lookout for new flavors and interesting, creative approaches to their beverages — stout versus ale; hops versus malt; smooth versus bite. As a result, craft beer production is up 9.6%, while overall beer production is down 1.4%, according to a 2014 industry analysis by market tracking firm Technomic. And here's the kicker: The Wall Street Journal reported last year that Americans now buy more craft beer than they do Budweiser.

Current trends also suggest we'll continue to see momentum in the number of advisory teams breaking away. According to a Cerulli Associates report this year, the independent model's market share grew 6% from 2007 to 2015, and we're seeing an increasing number of large — in particular, very large — breakaways.

Prior to striking out on their own, most of these large teams were already structured like enterprises, with defined roles and multilevel client support systems in place. This positions them for better success when they go independent. Earlier breakaways led the way to robust, sophisticated and agile providers in the RIA sector. As a result, big teams are finding exceptional quality in research, technology, client services and back-office support.

Newly independent advisers can take a thoughtful approach to setting up their firms, from choosing the right vendors, custodians and suppliers to determining how to organize their teams and talent. They also know that they won't have to wait years to access new products. Since they're in charge of their firm's technology choices, they can select next-generation tools that position them for ongoing growth.

MARKET SHARE GROWTH

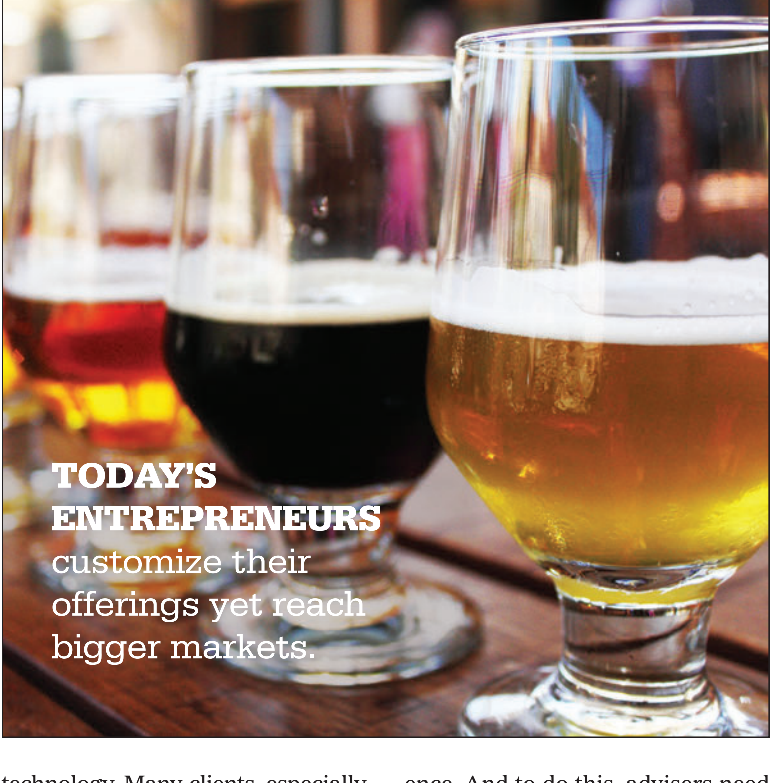
In 2010, craft breweries accounted for just 5% of the beer sold in America, according to the Brewers Association. Market share grew over the next five years and by 2014, one of every 10 beers sold in the U.S. was artisanal. Nonetheless, less than 2% of the breweries in the country account for 89% of the beer brewed and the other 98% of the breweries made only one-tenth of the beer sold. But these small breweries account for one-sixteenth of the money spent on beer.

That is a case study of a value stack getting upended.

The financial advice value chain is also in the process of being upended. Historically, investing was the foundation of the adviser-client relationship. Now, the situation is flipping because of technology and investor preferences. Large breakaways are recognizing the need to build a solid foundation around financial and wealth planning — the services that are much less likely to be commoditized now.

Combine this with the generational wealth transfer, and you get an extraordinary value-creation opportunity for advisers. The big teams that are choosing to go independent are seeking to act on this opportunity. They're also looking to capture the value they've created as successful teams within large institutions.

The value generated by independence can be especially evident when advisers compete for significant new client accounts. Increasingly, traditional teams are facing large breakaways with forward-thinking advisers and leading-edge technology. Many clients, especially younger ones, are now choosing independent firms.



TODAY'S ENTREPRENEURS customize their offerings yet reach bigger markets.

CURATING THE EXPERIENCE

American craft breweries produce more than 100 distinct styles of beer that make use of traditional brewing methods and emphasize flavor and quality over mass production and marketing. But more than that, craft beer has come to reflect an alternative approach to brewing that's based on creativity, adaptability and customer service. The field is largely made up of passionate innovators who are driven to curate unique experiences for their customers.

That sounds a lot like the large breakaways who are creating high-touch service models with customized solutions and open-architecture platforms. These are entrepreneurs who took a leap of faith to create a business out of their skills and passion. They know that as the industry evolves, size alone won't be sufficient for success; firms need to become curators of the client experience. And to do this, advisers need the freedom to provide services and products that help to best meet their clients' needs.

Having a clearly defined focus is essential, and it should be articulated to clients in a consistent, meaningful story.

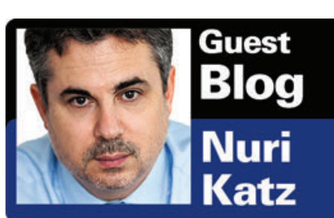
As part of this strategy, large breakaways are setting up practices that highlight their commitment to helping clients manage the "moments of truth" in their lives.

They also understand that these services will be the core of successful financial advisory businesses in the future. This will require an intimate understanding of their clients, along with an unwavering dedication to guiding them through market conditions to their goals. And that's a future I'll be very happy to welcome with a uniquely brewed and well-flavored craft beer.

Bob Oros is executive vice president and head of the RIA segment for Fidelity Clearing & Custody at Fidelity Investments.

Helping clients who are considering a second citizenship

In today's evolving financial landscape, investors are looking to their financial advisers for advice on investment opportunities to help preserve capital — and citizenship by investment is one avenue high-net-worth investors can pursue to achieve these goals.



Citizenship by investment provides investors with a means to leverage investment in real estate, government bonds or other financial instruments to attain a second citizenship in a country that provides financial, tax or other advantages over one's existing country of residence.

Why would a U.S. citizen seek second citizenship? One of the reasons many high-net-worth Americans invest in other countries is to diversify their assets. For some, the size of the federal government causes great worry. They become concerned that as the government's needs grow, lawmakers may go after their assets, making diversification by attaining a second citizenship an important solution. Living and placing assets outside of America makes it more difficult for the government or others to pursue one's assets through taxes.

PEACE OF MIND

Investors can gain peace of mind knowing they have the rights of a citizen in another country where their holdings and income exist.

Another area of concern surrounds succession. In the United States, there are significant succession and capital gains taxes when investors pass hard-earned assets to their children. While most Americans use trusts and other maneuvers to protect their assets, becoming a citizen of another country that does not tax inheritance can create considerable savings without having to use complicated and perhaps unreliable corporate structures to pass on wealth.

What kinds of investment products facilitate second citizenship? Existing opportunities for citizenship by investment programs require that applicants for citizenship or residency invest in assets such as government bonds or real estate. For example, a U.S. citizen could invest $2.76 million in Cyprus government bonds or a publicly traded company on the Cyprus stock exchange to attain citizenship. Another option would be to invest in government funding for infrastructure, a one-time payment that is often nonrefundable but achieves the desired goal nonetheless.

APPLICANTS for citizenship often invest in government bonds or real estate.

Tax benefits to pursuing a second citizenship. The U.S. is unique in that U.S. citizens who move to another country — at any age — continue to pay taxes to the U.S. on their income for the rest of their life. In most countries, income tax is paid only to the country that you call home.

ADVANTAGE FOR EXPATRIATES

But there are tax advantages Americans can achieve by expatriating. If your client has been tax compliant while a U.S. citizen, he or she may pay a one-time capital gains tax, which may be close to 20% of total net worth. For those whose annual income is over $1 million or those living off passive income investments, this one-time fee may be more than accounted for in future savings created from the reduced income taxes associated with second citizenship. For example, someone making $2 million per year with a total net worth of $10 million may pay this one-time fee and live the rest of their life with a significantly reduced tax structure.

Obtaining a second citizenship is an important and difficult decision. If you have clients who are comfortable forgoing their American citizenship to examine moving elsewhere, there is a significant opportunity to preserve considerable capital. Ultimately, their tolerance for lifestyle change becomes paramount.

Nuri Katz is president at Apex Capital Partners, an advisory firm specializing in investment consulting and wealth management for multinational, high-net-worth clients.

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Understanding the different long-term-care products

By Greg Iacurci

Traditional long-term-care insurance and combination life insurance-LTC policies are the primary products advisers use to secure LTC benefits for clients. But there are subtle differences between them that advisers should be aware of when considering how they fit into a client's financial plan.

Deciding between traditional and combination products is causing some advisers to avoid discussing LTC coverage with clients.

Traditional LTC has floundered over the past several years, partly due to rising premiums, at the same time combination policies have boomed.

Combination policies, also known as linked-benefit products, are life insurance products with a long-term-care component. They fall into two categories: hybrid life-LTC policies, and traditional life insurance policies with an LTC rider.

There was a 60% dip in new traditional LTCI policies sold from 2008 to 2014, from 300,000 policies to just 120,000, according to the American Association of Long Term Care Insurance. At the same time, there was a 525% growth in combination policies, ballooning to 100,000 from 16,000, according to Limra, an industry group.

"Right now [linked-benefit products] are a juggernaut," said Jesse Slome, executive director of the AALTCI.

ACCELERATED BENEFIT

Through combination products, investors accelerate their life insurance benefit, dipping into that pool of money ahead of death in order to cover long-term-care costs. The death benefit is reduced dollar for dollar by the cost of the LTC care needed. In the event that life insurance pool is extinguished, an LTC benefit is triggered. Those benefits can differ depending on the contract, but they often provide an additional LTC asset pool to draw from until exhausted.

"If I have a death benefit, I can turn that into a living benefit," said Caleb Nitz, vice president of insurance marketing at ValMark Securities Inc., an independent broker-dealer.

For clients who need both life and LTC insurance, advisers should consider a linked-benefit product, according to Gregory Olsen, partner at Lenox Advisors Inc. But if a client doesn't want to pass on a death benefit to beneficiaries, a traditional LTC policy without a life insurance connection is better, Mr. Olsen said.

The difference between the two linked-benefit types comes down to leverage, or how much of a benefit a policyholder gets in a particular area, Mr. Nitz said. Advisers have to weigh what's most important to a client, between a combination of long-term care, life insurance and contract liquidity.

For example, Michael Fontanini, director of advanced sales at distribution company Lion Street Financial, refers to hybrid products as "asset-based" — they're typically sold through a one-time upfront premium and have a return-of-premium liquidity feature built in if an investor surrenders the policy and hasn't used any of the benefits.

Clients can cancel the policy and get the cash value back without penalty, sometimes immediately or after a number of years, depending on the contract. In this case, liquidity might make the policy more attractive to a policyholder than traditional life policies with an LTC rider, which don't have a similar liquidity mechanism.

"If you have buyer's remorse, you can get your money back. The only thing you gave up is the opportunity cost of investing that money," Mr. Nitz said.

That opportunity cost is something advisers need to explain to clients, according to Mr. Slome. Clients should consider they could earn higher returns outside the contract, especially if they buy a policy during the current low-interest-rate environment and lock in a low rate, he said.

Mr. Nitz said traditional LTC insurance is the cheapest way to buy long-term care.

Traditional LTC is approximately three to four times cheaper than other vehicles, according to a recent cost analysis published in the Journal of Financial Planning. The analysis shows the normalized initial cost of capital needed to fund LTC products.

"YOU'RE BUYING a product doing double duty, and that's been calculated into the price."
Jesse Slome
Executive director
AALTCI

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COST COMPARISON

For example, in order to receive a $6,000-per-month LTC benefit from a traditional LTC policy, investors would need to invest around $70,000. That compares to $210,000 for a hybrid LTC, $268,000 for universal life insurance with an LTC rider, and $290,000 for variable universal life.

"You're buying a product doing double duty, and that's been calculated into the price," Mr. Slome said. "Something that does two things will always cost more than something that does one thing."

Traditional LTC policy premiums were $2,400 on average for contracts purchased in 2014, according to Limra. However, it's important to remember that traditional LTC premiums beyond the first year aren't guaranteed and could go up, according to Zachary Hurst, an investment marketing analyst at ValMark.

Peter Gaines, a financial planner for Integrated Financial Partners, said he doesn't consider hybrid products for clients who can pay a fairly substantial upfront payment, which could be $100,000 or more. Some products allow the phase-in of premiums over a number of years, but it's still much more than the typical premium on a traditional LTC contract, he said.

The flexibility to put a client's money to work in more than one way inside combination policies is an attractive quality, according to advisers. That's different from the use-it-or-lose-it scenario of traditional LTC — much like auto insurance, if policyholders don't tap the benefits, they won't receive any sort of money back for the contract premiums they pay.

That combination policies provide an LTC and death benefit, as well as allowing money to be tapped for income in case of emergency, is "very easy to explain and is very desirable for my client," Mr. Olsen said.

To qualify for most LTC benefits, people must demonstrate a need for assistance with two of six activities of daily living — bathing, dressing and eating, for example — or have a cognitive impairment, such as Alzheimer's disease.

Depending on the specific policy, insurers may pay out LTC benefits on a reimbursement or indemnity basis. Under reimbursement, benefits are equal to the expense of care, and costs will be reimbursed only if they are qualified under the contract.

Indemnity offers a cash benefit — if policyholders meet eligibility criteria, meaning they are receiving a particular type of care as defined by the contract. They can receive a regular check in the mail for, say, $1,000 per month, which they can distribute however they wish, Mr. Fontanini said.

Reimbursement generally doesn't allow payment for expenses incurred by family caregivers, Mr. Fontanini said. According to figures cited by the Family Caregiver Alliance, two-thirds of older people with disabilities receiving long-term services and support get all their care from a family caregiver. A quarter receive a combination of family care and paid help.

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Fastest-growing RIA seeks to cut tax bite

Bloomberg News

Investment adviser Cheyne Pace is preoccupied with tax efficiency — a focus that's helped him attract $1.7 billion in client money since he founded Yale Capital in 2004. Last year, when he thought about relocating, tax advantages were among the things he considered before moving himself and Yale's headquarters to Dorado, Puerto Rico.

U.S. investors are bemoaning the tax drain on their savings and seeking help to reduce the bite. Millionaires worry more about taxes than terrorism, ranking the issue third behind the political environment and government gridlock among their national concerns, a 2015 survey by research firm Spectrem Group found.

LEVIES ON WAGES, GAINS

Wealth managers say they're working more on tax issues since the federal government boosted the levies on wages and investment gains of big earners in 2013 for the first time in a decade. Today, the marginal income tax rate on earnings above about $400,000 is 39.6%, up from 35% in 2012. On top of that, some states target their richest residents. California raised its top marginal rate to 13.3% in 2012 from 10.3% on income above $1 million.

"I NEED TO MAKE sure their net return is as high as possible."
Cheyne Pace
Founder
Yale Capital

Mr. Pace, 47, chooses investments from oil pipelines to shares of bank stocks that pay tax-preferred dividends to help clients build savings and lose less to levies. "I need to make sure their net return is as high as possible," he said. "One of those components is fees, and the other is taxes."

Yale boosted its assets under management 70% last year, making it the fastest-growing firm in Bloomberg Markets' second annual ranking of registered investment advisers.

Mr. Pace works with 35 family groups who have at least $10 million apiece to invest. They're mainly entrepreneurs and executives from oil, gas, pharmaceutical and technology companies. Many have a lot of their wealth in the stock of a company they took public or that they got in an acquisition. He's helped them protect against losses by transferring some of that stock into so-called exchange funds, which also hold shares from executives at other corporations. The strategy lets clients both diversify and defer taxes on gains because it doesn't trigger a sale, Mr. Pace said.

One of the firm's most successful investments is master limited partnerships. MLPs hold pipelines and other assets that transport natural resources, rather than the commodities themselves. When profitable, the securities provide distributions, similar to stock dividends, and offer tax deferrals on most of the income an investor receives.

Mr. Pace bet clients' money on a natural gas-transporting MLP called Energy Transfer Equity. The partnership gained more than 468%, with dividends reinvested, from 2007 through 2014. He's still a fan despite a 26% drop this year through mid-October in MLPs in general and a plunge in overall energy prices.

TARGETING SILICON VALLEY

Mr. Pace got his MBA at Yale University, where he focused on asset allocation. He kicked off his wealth management career at Goldman Sachs in 1994, a year when MLPs were first catching on. He moved to Merrill Lynch in St. Petersburg, Fla., in 1999. To win business, he cold-called Silicon Valley entrepreneurs whose companies were going public. When he broke out on his own to form Yale about five years later, clients with about $180 million in assets joined him. Today, he owns more than half of the business.

While some financial professionals register as advisers and brokers, Mr. Pace is only an RIA.

Yale's clients currently get no tax relief from the move to Puerto Rico. But owners of investment firms who become residents pay no capital gains taxes when they receive a percentage of the investment profits, said Gabriel Hernández, who heads the tax division of accounting firm BDO Puerto Rico. If the Puerto Rican company passes distributions or dividends to owners from the fees it collects, those are tax-free, too, he said.

There's a catch: You must live in Puerto Rico at least 183 days in a year, show close social ties and employ at least three Puerto Rican residents at the firm. Mr. Pace said he's trying to become a resident himself, but any tax advantages for him are still unclear.

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Some funds rallied amid China's crash

Top performers gained 70% as 1,300 other funds were wiped out

Bloomberg News

China's summer market selloff wasn't a total rout for the country's top-performing hedge funds, which gained an average 70% as almost 1,300 other funds were wiped out.

The country's top 10 performers, run by Ze Quan Investment, Sunrise Investment, Zexi Investment and Yingyang Asset Management, realized gains in the June-August period by heeding a famous maxim: Markets are ruled by fear and greed.

"I was scared," said Jiao Ji, chairman of Sunrise, who dumped all his stock holdings in May, sat out the post-June 12 crash and then made strategic purchases on brief upswings prompted by government intervention in July. Chasing gains at the top of the market was like "sucking blood from the tip of the knife," he said.

Four of Sunrise's funds made the Top 10 list of the 2,193 stock funds in China in the three months through August, according to Shenzhen Rongzhi Investment Consultant Co., which tracks hedge funds. All 10 funds had sold their holdings or stayed out of the market before the June selloff.

NOT BIG HEDGERS

Chinese funds have few sustainable strategies to avoid large declines. They mostly only buy and sell shares, rather than engage in tactics such as short-selling and trading in stock-index futures, which Chinese authorities have clamped down on since the market crash. While private investment firms are broadly categorized as hedge funds in China, they differ from their global counterparts in not making extensive use of hedging strategies. That makes it harder to produce consistent returns.

"Pure market timing is very difficult, if not impossible, from a statistical point of view," said Hong Yan, director of the China Hedge Fund Research Center. Timing it right becomes crucial because "there are no other tools" for hedging, such as derivatives, he said.

China's stock hedge funds as a whole suffered an average 18% decline from June through August, according to Shenzhen Rongzhi data, while the Shanghai Composite Index fell 30% during the three-month period. The mid-June market crash spurred a $5 trillion sell-off. Almost 1,300 hedge funds had been liquidated this year as of the end of August, according to Howbuy Investment Management Co., and only 303 of 2,193 stock funds recorded gains during the June-August period, according to Shenzhen Rongzhi.

Since the end of September, however, the index has risen 11%, prompting some funds to inch their way back into the market. Yingyang Asset Management, whose stock fund was among the top 10, said it expects a 15% market rebound in the fourth quarter, spurred in part by the sharp drop in valuations.

The market rose more than 150% in the 12 months through June 12. Some of the top performers' high returns were due to just the first two weeks of June before the crash. Gains from June 1 to June 12 alone were big

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> "WE DON'T DO bottom-fishing. We leave the risk of that to others."
>
> **Xin Yu**
> Manager
> Ze Quan Investment

enough to generate a 129% return for the three-month period at Ze Quan Investment's top-performing Jingbo Wealth fund, said manager Xin Yu.

EXITED NEAR THE TOP

Mr. Jiao's Sunrise funds, including its Risheng and Ririsheng offerings, rose an average 61% during the June-August period. He was prompted to sell in May by seeing large amounts of borrowed money, or leverage, being used to make stock purchases and valuations approaching the highest levels since 2009, even as the nation's economic slowdown continued.

"People didn't believe me then because the market was still surging like every day," Mr. Jiao said.

Mr. Xin's Jingbo Wealth hedge fund also exited near the top of China's stock market. His funds started to trim positions after the Shanghai gauge topped 5,000, dumping their last stocks on June 12 as the index peaked at 5,178. The funds have since kept stock exposure at about zero, he said.

"The market was frenzied," said Mr. Xin, who manages more than 6 billion yuan ($944 million) as chairman of Ze Quan Investment.

The market rallied briefly in July as the government stepped in with measures attempting to ease the panic. The Shanghai index rallied 18% in the two weeks ended July 23 after authorities gave state-run China Securities Finance Corp. access to as much as 3 trillion yuan of borrowed funds to prop up stocks, banned large shareholders from selling stakes and ordered state-run institutions to buy shares.

Mr. Xin said market risks are much smaller now than they were in June, but he is still sitting on cash and waiting for clear signs that a rebound is under way.

"We don't do bottom-fishing," he said. "We leave the risk of that to others."

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Reading the tea leaves as Fed mulls rate increase

Six things to watch for ahead of central bank's Dec. meeting

Bloomberg News

Federal Reserve officials said Oct. 28 that they are considering raising interest rates in December, setting the stage for the first increase since 2006. Paramount to the decision will be the "realized and expected" progress that the economy makes over the next few weeks: the data that come out and the way policymakers interpret those numbers.

Here are the six things to watch ahead of the central bank's next gathering, which takes place Dec. 15-16 in Washington.

1. Third-quarter GDP

Just a day after its October meeting, the Fed got the first details on how the economy fared in the third quarter. Gross domestic product rose 1.5% compared with a 3.9%increase in the prior three months, a Commerce Department report showed. That gain was in line with the 1.6%

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rate projected in a Bloomberg survey of economists. The slowdown came as companies reduced bloated stockpiles, so many economists say it will be short-lived. Revisions to these figures will be released on Nov. 24. While economic growth isn't explicitly part of the Fed's dual mandate of stable inflation and maximum employment, the strength of the economy matters hugely for those goals.

2. Inflation data

Officials will see two prints of a bread-and-butter indicator, the price index tied to personal consumption expenditures, between this meeting and next. The Fed's preferred inflation measure probably climbed 0.2% in September from a year earlier, a slight slowdown from the 0.3% increase in the 12-month period through August, based on the median estimate in a Bloomberg survey of economists. That is well below the Fed's 2% target.

3. Janet Yellen

Fed Chairwoman Janet Yellen testified last Wednesday on regulatory matters to the House Financial Services Committee. In early December, she will speak to The Economic Club of Washington and testify to Congress' Joint Economic Committee. Her two appearances should give Ms. Yellen plenty of time to air her views on how the outlook for growth is shaping up.

4. Stanley Fischer

Federal Reserve Vice Chairman Stanley Fischer was scheduled to give a memorial lecture to The National Economists Club last Wednesday. As the Fed's No. 2, every word Mr. Fischer says matters to monetary-policy watchers. In his most recent speech on Oct. 11, he gave some valuable insight into where he personally sat on monetary policy as officials submitted their economic projections in September. "Most participants, myself included, anticipated that achieving these conditions would entail an initial increase in the federal funds rate later this year," he said.

1.5%
Third-quarter increase in GDP

5. Fresh jobs data

The Fed recognized in its October policy statement that labor market gains have slowed. Officials will have two more readings of the monthly jobs report on hand before December's meeting to help assess how close we are to full employment. Policymakers in September indicated that they see the long-run jobless rate at 4.9%, and unemployment stood at 5.1% that month.

6. William Dudley

Federal Reserve Bank of New York President William Dudley will speak Thursday on the economic outlook and what it means for monetary policy at The Economic Club of New York. This will be a headline event because, as a full-time voter and president of the Fed district that contains Wall Street, Dudley is often viewed as the third-most important member of the FOMC behind Ms. Yellen and Mr. Fischer. He's also fairly moderate on policy, which make his views a good gauge for which way the wind is blowing inside the committee.

Bonus: Fed minutes

Fed watchers will learn a little bit more about what happened at October's meeting in mid-November, when the central bank releases minutes from the gathering. Why did the Fed add a reference to the next meeting? Why did it drop language saying global economic and financial developments "may restrain economic activity somewhat"? Details could emerge.

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How clients can invest in global infrastructure

Much of the growth in spending expected to occur in Asia-Pacific

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Worldwide, infrastructure spending is expected to grow to over $9 trillion per year by 2025, up from $4 trillion in 2012. Overall, global spending on transportation, power generation, telecommunications networks, public facilities and other infrastructure over the next decade is estimated at nearly $78 trillion.

While this building boom potentially will drive economic growth and job creation in many regions, it can have an equally powerful effect in building wealth for investors who make infrastructure a core holding in their portfolios.

For the past few years, questions have been raised about whether infrastructure is truly an asset class. As infrastructure represents a distinct set of assets, that issue seems largely settled. However, it is important to ask how financial advisers and their clients can best allocate to this increasingly important class.

STRATEGIES

At Alpine Funds, we believe that investors who seek to benefit from the global infrastructure boom should consider three possible allocation strategies: 1) shift some emerging market exposure to more-stable infrastructure holdings; 2) employ infrastructure funds as a part of an income portfolio; or 3) consider it as a separate thematic investment. Which of these approaches clients and their advisers choose will, of course, depend on specific investment objectives and risk tolerances.

The case for allocating to the infrastructure class reflects, in part, powerful global demand. Much of the expected growth in spending will come from the Asia-Pacific region, where emerging middle-class consumers and increasingly urban populations are creating a vast need for water, transportation, energy and telecom projects.

Even in the U.S. and other developed countries, the need to upgrade aging airports, roads, bridges and power grids is acute. Additionally, infrastructure investments can be attractive income vehicles, as most projects are structured with specific revenue generation components. Given the potential benefits of infrastructure investment, let's look at the different allocation strategies in more detail.

EQUITY DIVERSIFIER

Investors holding international equity portfolios may want to allocate to infrastructure funds to diversify exposure in what has recently been a volatile asset class. Many international funds, especially those focused on emerging markets, are overweighted in commodities and the financial sector. For investors who still want some exposure to emerging markets, global infrastructure is a viable option because it's supported by solid demand and is uncorrelated with other asset classes such as commodities or financials.

INCOME VEHICLES

Shares in an infrastructure fund are equivalent to "owning the owners" of revenue-generating assets. Yield is produced by a relatively dependable stream of income from toll road concessions, water usage charges, airport landing fees, etc. This makes allocating to infrastructure funds a logical choice for investors who want to invest globally and yet also receive dividends or income.

THEME INVESTMENTS

Finally, infrastructure funds may make sense for investors who wish to capitalize on major global themes, such as the emerging middle class or urbanization. Global infrastructure provides more direct exposure to these trends than more generic thematic plays, such as international investing.

The potential drawbacks to infrastructure investing include interest rate risk, as a rise in real rates could affect economic returns. Political and regulatory decisions can also affect the support for or returns on infrastructure investments.

That said, for investors who believe an allocation to infrastructure makes sense, a global infrastructure mutual fund may be the best alternative. Private-equity infrastructure funds are generally illiquid and are not accessible to most investors, while infrastructure master limited partnerships can complicate one's tax filings.

Infrastructure mutual funds provide relatively liquid, simplified vehicles for accessing a diversified portfolio of infrastructure projects, helping investors to potentially build a road to their financial goals.

Joshua Duitz is a senior portfolio manager at mutual fund provider Alpine Woods Capital Investors.

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Help clients find right balance between competing goals

Money is often at core of their trade-offs between priorities

We completed research that asked families to share their financial life stories and tell us about the lessons they learned at major turning points. There were many interesting facts but, by far, the most fascinating to me was that human financial life is an enduring struggle between the ideal life we want and the lives we end up living. Money and how we spend it are at the core of this conflict.

A LIFE FILLED WITH REGRET

Let's illustrate with the story of Sam, an accomplished gentleman in his 70s who had amassed a seven-figure fortune. He had worked hard his whole life to build his nest egg, sacrificing mightily along the way to get there. Whenever there was a choice between living the life he wanted, or building his net worth, he went for the money. That meant endless work and constant travel. It meant always placing his own desires for his ideal life behind his quest for wealth. Surely many of us know our own version of Sam. Perhaps we have budding Sams who are our clients today.

Ultimately his choices led to several failed marriages and broken relationships with his children. He had built a multimillion-dollar net worth and a life filled with regret.

Sam had worked with wealth managers for decades, but none of them thought it was their job to help him align his financial life ideals with his money.

This might be an extreme example, but every day, people struggle with this. How involved should we advisers be in helping people live a life that is rich and not filled with regret?

FINDING A BALANCE

Regret happens when we make choices that do not live up to our ideals. Money is often at the center. There are three questions most people have to answer to find the right balance between building their net worth and building their best financial life:

1 Why do you work? What is the primary purpose of your money? We all have our own reasons and things we want, whether it's to spend time with people we love or to spoil our families. Having a systematic way of identifying people's ideals and priorities is the single most important way of ensuring they make the right choices.

2 When you have to choose, how will you decide? Human desires are limitless, so life is a constant set of trade-offs. When you have to decide between a higher-paying job that requires time away from your family or staying put — or whether to pay for a child's private school education or a nicer home — how will you decide? Having a clear set of priorities is crucial, but so too is a process to make the inevitable trade-offs in a way that maximizes the outcome and aligns with your ideals.

3 How do you overcome your biases? We all have biases that cloud our judgment. Perhaps few roles matter more for any adviser than helping clients to make the right choices. Along the way, we advisers also have to break our own long-held bias that our primary job is to focus on building people's net worth above all else. Money is not the destination, it is the gas in the car.

Money is often at the central point of compromise between who we are and who we'd like to be. Is there any greater purpose we can serve than helping people ensure that their money serves them and not the other way around? There is no greater service to the people we work with than helping them make the right choices.

Joe Duran is chief executive of United Capital. Follow him @DuranMoney.

ISTOCK

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Building a more proactive regulatory framework

The following is an edited version of comments given by Securities and Exchange Commission Chairwoman Mary Jo White on Oct. 28 at the Securities Regulation Institute in New York.

I am very pleased to be here to help kick off the 47th Annual Securities Regulation Institute.

I have selected a topic that I think is well-suited for a conference of such endurance and importance: how the commission is building a more proactive and responsive regulatory framework to better assess the impact of regulatory changes on investors and issuers over time in the context of securities offerings. This important area has seen tremendous regulatory change over the last 10 years, including significant new rules in the past year.

The commission acts as both a facilitator and a guardian of the capital markets. Certainly, issuers should be able to raise capital without needless friction or cost — in fact, our mission rightly calls for it. If focused too tightly, however, the regulatory lens can become myopic if there are single-minded demands to reduce "barriers" and eliminate "costs" to enhance the ability of companies to issue securities. Disclosure and other measures we require and enforce in capital raising are not simply barriers or costs; they are the ground rules that promote confidence, fairness and efficiency in our markets. Investors are willing to invest because they know protections are in place that will be enforced. This dynamic is at the heart of our mission: Capital formation does not occur in spite of investor protection; it occurs because of it.

In pursuing its mission, the commission's actions cause a variety of reactions by market participants, sometimes with unpredictable consequences. The commission tries to foresee these effects and respond accordingly. While this challenge is always present, it seems particularly acute in the regulation of securities offerings. There, the rules must address directly the fundamental choices of investors to buy and issuers to sell, while also contending with a multitude of other factors at play in these choices: macroeconomic conditions, the terms of a particular offering, shifts in technology and consumer preferences, and many more.

BLOOMBERG

> *However, the regulatory lens can become myopic if there are single-minded demands to reduce "barriers" and eliminate "costs."*
>
> **Mary Jo White**
> Chairwoman, SEC

THE NEW RULES

Ten years ago, this challenge of prediction and response was posed in securities offering reform. Today, it arises from the new rules flowing from the Jumpstart Our Business Startups Act of 2012. But simply writing rules is not enough to address the changes in this new environment; we need a more responsive and agile regulatory framework. And so my central question is: how can the commission do a better job of assessing the impact of the rules governing offerings on an ongoing basis, so that we can respond more nimbly to issues that arise, whether through guidance, amended regulation, enforcement or the other tools at our disposal?

The commission already has a strong foundation for this task. Our rule makings today incorporate an extensive analysis of the relevant markets and potential impacts, drawing on deep expertise from our Division of Corporation Finance and Division of Economic and Risk Analysis. The staff regularly helps parties navigate new rules, provides interpretive guidance and identifies potential rule changes where necessary. And our rules are matched with strong enforcement, as evidenced by the exceptional series of high-quality cases brought over the last year.

But I would like to discuss today how we are doing more. I will start with a brief "case study" of securities offering reform. I will then touch on

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the significant reforms for offerings brought about by the JOBS Act, and what we have done to begin to assess their impact. And finally, I will describe our focus on improving our ability to adjust to new market practices and other developments following new rules for offerings.

A CASE STUDY

Since 1933, securities transactions in the United States have been required to be registered or conducted pursuant to an exemption from registration. The framework of the Securities Act — familiar to us all — has proven to be enormously successful over the years at meeting the needs of issuers and investors, in part because of the flexibility it affords the commission to respond to the needs of investors, companies and the market.

More than 10 years ago, the commission identified changes to the economic and regulatory landscape that supported just such a response. Advances in communication technology, particularly the use of the Internet, had increased the market's demand for more-timely corporate disclosure. Lower computing costs and the proliferation of new software and services also enhanced the ability of issuers to capture and provide this information to investors. And significant regulatory changes required faster financial reporting by issuers and, as required by the Sarbanes-Oxley Act, more-frequent review of financial statements.

"Securities offering reform," as it came to be called, was intended to absorb these developments, among others, and improve the offering process. The commission, shifting to facilitate issuers' ability to communicate more freely with potential investors, did three basic things.

First, it created new classes of issuers, including the well-known seasoned issuer, or WKSI. This term is used to describe the largest established issuers that were widely followed by investors and analysts in the marketplace. In light of their widespread following and ongoing reporting requirements, offering reform created an automatic "shelf" registration statement for use by WKSIs that allowed them to register securities on a more flexible basis, without requiring a waiting period.

The second part of the rule making was a number of new communication rules designed to facilitate the free flow of business-related information to investors, such as through media, electronic road shows and free writing prospectuses.

And third, most critically, the commission tailored the strong investor protections of the federal securities laws to fit these new rules and the new communications environment.

THE JOBS ACT

So, did securities offering reform work? By many measures, yes. For one, the new tools are used quite a bit. Over the three-year period that ended on Sept. 30, 2014, WKSIs undertook more than 1,500 equity offerings, almost three per issuer, with gross proceeds totaling about $523 billion. Over the same period, WKSIs also undertook more than 2,700 debt offerings, more than three per issuer, with gross proceeds totaling about $1.4 trillion.

While these numbers and similar ones suggest a positive reception by issuers, they do not fully illuminate the impact of the regulatory changes on investors — are they receiving the accurate information that is necessary for their investment decisions?

The data are rather limited, but do suggest that there has been an improvement in the frequency and quality of company disclosure since offering reform. One study found that allowing companies to supply voluntary disclosures immediately before an equity offering enables them to place potential investors on a more level playing field before the offering announcement. And a 2014 paper — co-authored by DERA staff — found that, as compared to pre-reform, companies tend to circulate a greater number of more accurate management earnings forecasts and file more free writing prospectuses and Forms 8-K in the 30-day period leading up to an offering.

This evidence is good news for investors generally, but there have also been some indications of potential issues. For example, there has been concern expressed by some fixed-income investors that offerings off the "shelf" can frequently involve truncated time periods that do not give them sufficient time to assess all of the factors necessary to evaluate the issuer's credit. These impacts cause our staff to ask whether any such issue could be addressed by increasing the speed and access by which investors obtain the necessary information or should we consider further adjustments to the 2005 rules, such as "speed bumps" like those introduced for certain asset-backed securities offerings last year?

The data ... do suggest that there has been an improvement in the frequency and quality of company disclosure.

In addition to these studies, reports and reports from investors, the staff's experience with securities offering reform provides a view into its overall impact. Because the rule making addressed registered offerings made by public companies, staff in the Division of Corporation Finance has a window into the offerings and ongoing financial disclosures made by these companies, so it can assess how they are working. The new JOBS Act exemptions present a harder challenge in assessing impact because we do not have the same window into many of the companies that are, or will be, engaging in these transactions. The changes brought about by the JOBS Act are thus fertile ground for a more proactive approach.

Companies began to take advantage of the initial public offering "on-ramp" as soon as the JOBS Act was enacted. Since that time, nearly 1,000 emerging growth companies — or EGCs — have confidentially submit-

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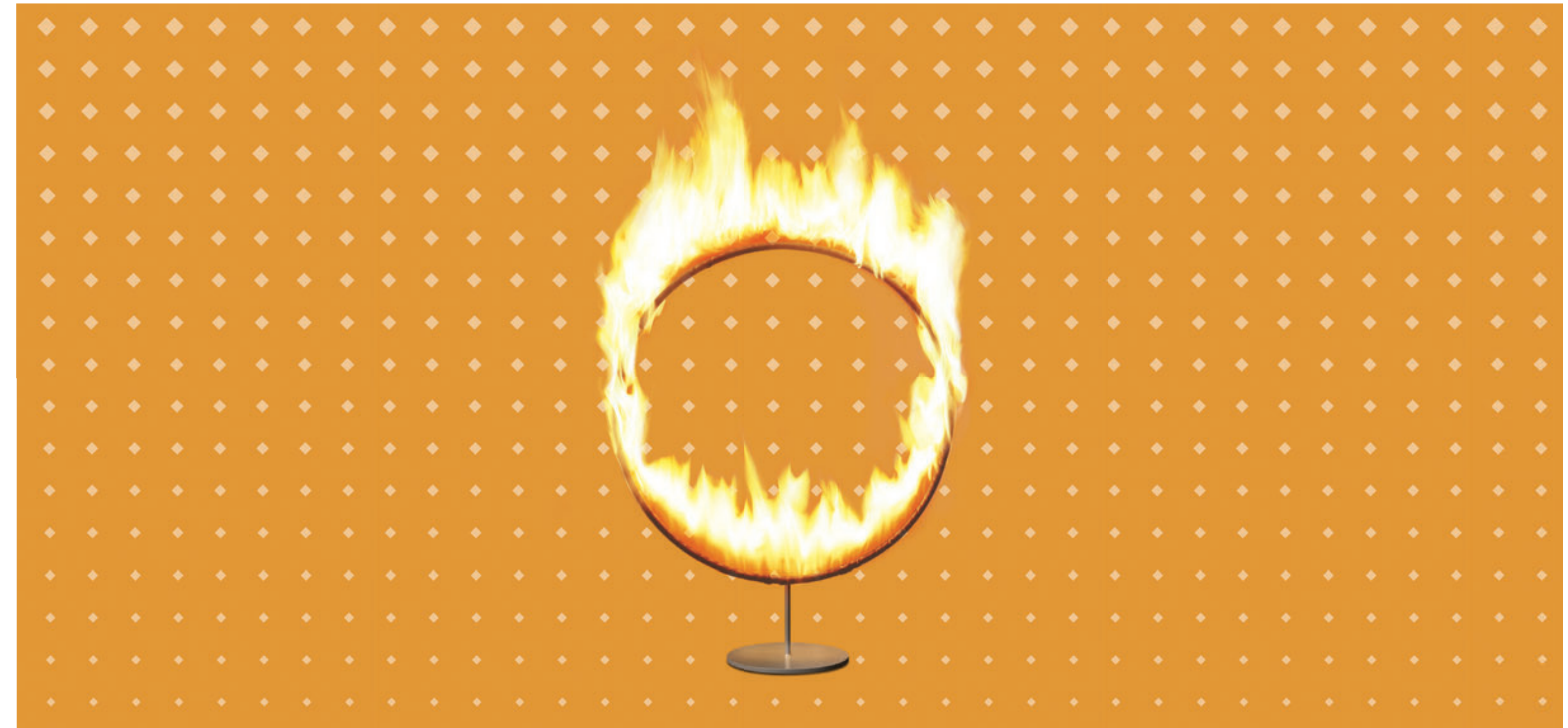

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More-responsive regulations

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ted draft registration statements for IPOs, and EGCs represent about 85% of the IPOs that have gone effective since the JOBS Act was enacted. The corporation finance division processes these registration statements the same way they do others, and generally the staff believes that compliance has been on par with non-EGC registrants.

The JOBS Act also directed the commission to amend rules for exempt transactions under Rule 506 and Regulation A, and to create a new exemption for crowdfunding. Final rules are in place for the first two, and I expect the third to be considered by the commission very soon. Let me touch on each briefly, starting with Rule 506.

SPEECH

Rule 506

Congress directed the commission to revisit a long-standing difference between public and private offerings by mandating changes to Rule 506 of Regulation D, a safe harbor for private offerings that prohibited general solicitation and advertising to the public. In 2013, the SEC carried out this mandate to lift the ban on general solicitation for certain Rule 506 offerings, provided that all purchasers are "accredited investors" and that issuers take reasonable steps to verify that status. The commission concurrently implemented an important investor protection by adopting disqualification rules that prohibit bad actors from participating in Rule 506 offerings. The commission also proposed rules to enhance our ability to collect important information on the operation of the new offering regime, which could help us assess its impact on investors.

Reg A amendments

The second JOBS Act measure relates to Regulation A, an exemption adopted in 1936 to allow businesses to raise relatively small amounts of capital through the sale of securities to the general public without incurring the full cost of registration and reporting. It was not widely used, and the JOBS Act sought to increase its utility by directing the commission to adopt rules to, among other things, significantly increase the permitted offering amount. The final rule, often called "Regulation A+," was unanimously approved by the commission earlier this year.

Crowdfunding

Finally, the JOBS Act directed the commission to adopt rules to implement a new exemption from registration for securities-based "crowdfunding." The commission proposed rules for this exemption that would allow investors to invest a limited amount of money in such offerings. The commission has since received more than 480 comment letters.

WHAT WE HAVE LEARNED

These are dramatic changes for investors and issuers. We have an obligation to implement them in a way that protects individual investors, promotes a general confidence in the new markets and is workable for issuers. That is why for all of the new JOBS Act offering rules, staff from across the agency — not just Corporation Finance and DERA, but Enforcement, [the Office of Compliance Inspections and Examinations] and other divisions and offices are engaged in closely monitoring practices as they develop. General solicitation under Rule 506, Regulation A+ and crowdfunding demand this heightened, more comprehensive effort. These new offering tools can reach a wider set of potential investors than before, in some cases investors new to the securities markets — investors who unfortunately may be most susceptible to fraudulent practices and most in need of our protection.

While it is too early to draw any conclusions from the operation of these new, interdivisional working groups, we do have some preliminary observations. Under Rule 506(c), issuers are taking advantage of general solicitation and advertising, but at a lower rate than issuers using the traditional exemption in Rule 506(b) that does not allow such activity. A record amount, $1.3 trillion, was reported as raised through Rule 506 offerings in the last completed calendar year, 2014. But only a small fraction of issuers claimed the new exemption permitting general solicitation.

It is hard to draw conclusions about the impact on investors of this change over such a short period of time, but the staff is continuing to collect and address the tips and

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complaints we receive. We have some investigations open, primarily focused on companies' failure to take reasonable steps to verify the status of investors, sales to unaccredited investors, unregistered broker-dealer activity and some instances of possible fraud. There has not been to date, however, a demonstration of the widespread fraud that some feared would occur.

As for Regulation A+, which just became effective in June, it is obviously too early to draw conclusions. Companies are beginning to take advantage of the new rules in greater numbers than was the case under the prior version of the exemption, with approximately 34 companies publicly filing offering statements and 16 companies filing nonpublic draft offering statements. The staff has qualified three offerings so far, and it remains to be seen how investors will react to such offerings.

WHAT'S NEXT?

Just as 2005 marked the end of an intense period of regulatory reform focused on larger issuers and their investors, final rules for crowdfunding would complete the far-reaching regulatory change for smaller issuers and their investors mandated by the JOBS Act. Throughout this period, the commission has been focused on how the new rules will work with one another and with the existing regulatory regime. We have gathered the available data and evidence, drawn educated conclusions and written the required rules accordingly.

With all of these changes, investors and issuers now face a very different world than when I became chairwoman in 2013, with new choices for both registered and unregistered offerings. As in 2005, we cannot know with certainty how the new rules will work for investors and issuers in practice. But it is our responsibility to take steps to understand the changes that occur in the market following implementation of these rules and to address any issues through both nimble regulation and unsparing enforcement.

We have always periodically reviewed the operation of our major rules, but today, with significant effort across our staff, we are proactively assessing how our rules for securities offerings are working so that we can more quickly:

- Evaluate their effectiveness and detect problems that may have arisen, such as investor fraud, investor confusion, or investor or issuer dissatisfaction; and
- Respond with guidance, changes to the rules, and enforcement initiatives as appropriate to correct the weaknesses or deficiencies we are seeing.

The concept is a proactive and responsive regulatory framework — initiated "out of the gates" following a rule making and marked by interdivisional collaboration and an enhanced role for DERA economists. The goal is to continue to protect investors throughout the development of an ever-more dynamic and multifaceted market for securities offerings.

ENHANCED MONITORING

The first aspect of the new post-regulation framework is enhanced monitoring and assessment — particularly as to the impact on investors. The working groups that we have established for recent rule makings are designed to develop a deep base of experience in their respective markets. The groups are tailored to each market — monitoring the use of general solicitation in private offerings is very different from monitoring offerings under Regulation A+. And these groups are intended to complement our agencywide initiatives to identify and address risks to investors and markets.

Very importantly, these monitoring activities help the staff better understand potential abuses and facilitate a rapid enforcement response. But they also help the commission identify new practices in the market that could impact investors, potential inefficiencies in the various offering methods, and relationships with other channels for building capital, such as bank loans and private equity.

The objective is to develop a broad understanding of the overall market that will serve as a firm institutional grounding for any future regulatory changes. When proposing or adopting any rule, the commission undertakes an extensive economic analysis of both the current state of the affected market and potential effects on that market. Thanks to our team of highly trained economists, we are putting this expertise to work not just in anticipation of a rulemaking, but also thereafter.

One small but important piece of this program is to explore whether we can more specifically identify the effects actually caused by a regulation we have adopted. Drawing the connection between a specific rule and an impact on investor protection or capital formation is notoriously difficult. An increase in the number of fraud actions or amounts of capital raised is far from conclusive — there are many other variables at work. But there are potentially critical insights to be derived from any con-

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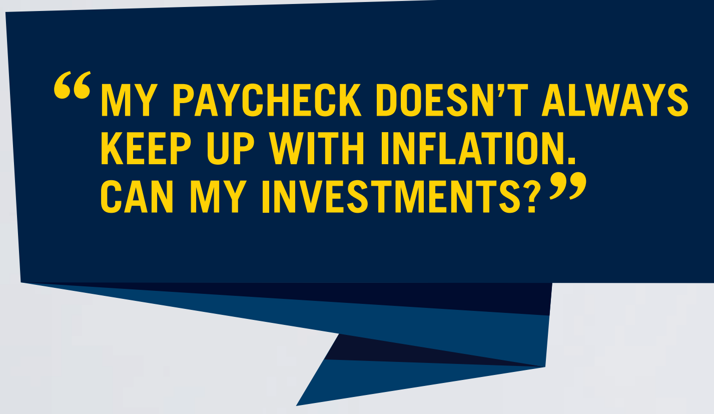
PRUDENTIAL INVESTMENTS » MUTUAL FUNDS



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Mutual fund investing involves risks. Some funds are riskier than others. The risks associated with investing in these funds include but are not limited to: **derivative securities,** which may carry market, credit, and liquidity risks (PURZX, JDEZX); **nondiversified,** so a loss resulting from a particular security or sector will have a greater impact on the Fund's return (PURZX, PRPZX); **foreign securities,** which are subject to currency fluctuation and political uncertainty (PURZX, JDEZX); **short sales,** which involve costs and the risk of potentially unlimited losses (JDEZX); **real estate,** which poses certain risks related to overall and specific economic conditions as well as risks related to individual property, credit, and interest rate fluctuations (PURZX). Unlike traditional open-end mutual funds, PRPZX is being taxed as a regular corporation, or a "C" corporation, and is subject to **U.S. federal income tax** on taxable income at the graduated rates applicable to corporations, as well as state and local income taxes. The Fund primarily invests in **Master Limited Partnerships (MLP)** and **MLP-related investments,** which are subject to complicated, and in some cases unsettled accounting, tax and valuation issues, as well as risks related to limited control and limited rights to vote, potential conflicts of interest, cash flow, dilution, and limited liquidity, and risks related to the general partner's right to force sales at undesirable times or prices. MLPs are also subject to risks relating to their complex tax structure, including losing its tax status as a partnership, resulting in a reduction in the value of the MLP investment and lower income to the Fund; **energy sector,** which subjects it to a greater degree to risk of loss as a result of adverse economic, business, regulatory, environmental or other developments affecting industries within that sector; **interest rate risk,** where its value will decline as interest rates rise; and investments in **initial public offerings (IPOs)** (PRPZX). The risks associated with each fund are explained more fully in each fund's respective prospectus. There is no guarantee a fund's objectives will be achieved.

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More-responsive regulations

Continued from Page 47
nection between rule and outcome.

At my direction, the Division of Economic and Risk Analysis is redoubling its efforts not only to enhance our ability to understand ongoing developments in the capital markets but also to try, to the extent possible, to understand the particular impacts of our rules after their implementation. Many of you have thought about the role of these connections in the marketplace, and I invite your input about how best to rigorously assess the impact of these regulations over time.

SPEECH

ENFORCEMENT

The second part of our responsive regulatory framework for securities offerings is the use of smart, targeted regulatory adjustments and enforcement. All too often, when investors or issuers have difficulties, there is a call for fundamental reform. It is important that we consider such measures. But we should also consider targeted adjustments directed at discrete problems. In many cases, these measures can be accomplished faster than more structural changes, and they can carry an outsized positive impact, particularly for enhancing investor protection.

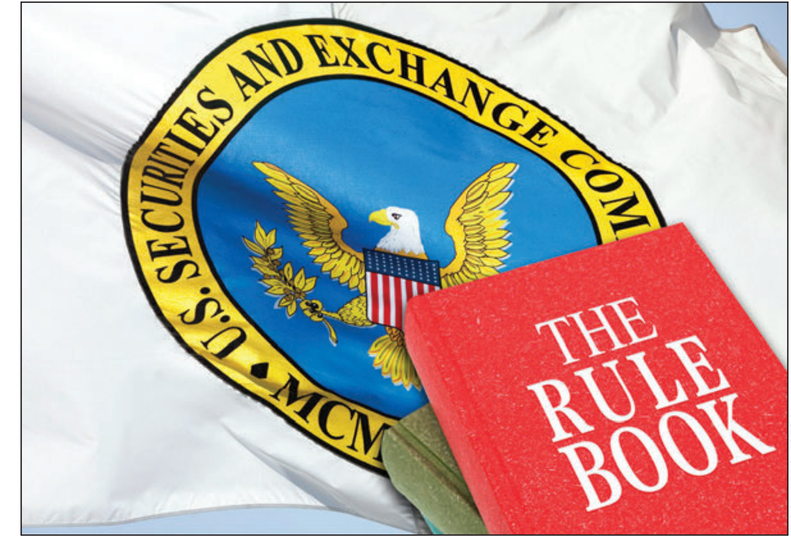
The commission's rules for disclosure are a place where we do this. A focused approach to enhanced disclosure can make a real difference quickly and with considerable impact. For example, in the wake of the financial crisis, the commission issued an interpretive release providing new guidance about disclosure on liquidity and funding in light of the complex financing alternatives available to modern issuers. Similarly, the staff has issued guidance on disclosures relating to sovereign debt exposures, cybersecurity risk disclosures and potentially misleading non-GAAP financial measures.

In addition, as you know, the Division of Corporation Finance, through its Disclosure Effectiveness Review, has been considering ways to improve the public company disclosure regime for the benefit of both investors and companies. As the core of our investor protections, disclosure must be as effective as possible for all investors, and this objective is fundamental to the staff's review. Investors need information that is presented in a transparent, complete and understandable manner. For the most part, our rules do a good job. But good disclosure is fundamentally about effective communication, and what is effective today may not be effective tomorrow. Sweeping reforms are not always required to address such changes, but the commission should be regularly recalibrating and updating its suite of disclosure requirements to adapt to continual changes in the marketplace.

To that end, the commission recently issued a Request for Comment for Regulation S-X. Our next step will be to address Regulation S-K and certain industry guides, including the guide for disclosures by bank holding companies and the guide for mining companies. As we move forward on this project, I will be keenly interested in investors' views on whether they are receiving the information they need to make informed investment decisions and whether the information is presented at the right time and in the optimal manner.

When market misconduct is readily and swiftly identified, fraudulent behavior is deterred.

Beyond regulation is, of course, enforcement. When market misconduct is readily and swiftly identified, fraudulent behavior is deterred and participants have increased confidence in the integrity of the markets. In focusing enforcement resources on these new markets as they become live, we are able to respond quickly to evidence of fraud or other misconduct and demonstrate to investors that we are protecting their interests. It is critical that we vigorously project our presence from the enactment of new rules to protect investors, both for their sake and the sake of issuers trying to raise capital through these new means. We cannot afford for investor confidence in these new offering regimes to be undermined, which would frustrate their fundamental purpose — helping companies raise the capital that fuels new businesses and jobs.



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At the SEC, we have embraced this critical responsibility with a new, interdivisional approach that seeks to monitor new rules from their inception so that our tools of regulation and enforcement can be quickly deployed. Through this dynamic regulatory framework, our objective is to ensure that offering reforms both past and present continue to serve investors and issuers in the securities markets that help drive a strong, vibrant American economy. Your input and observations are essential to the success of our efforts.

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Energy prices and MLP returns rarely remain in lockstep

Some key dynamics underlying the market in limited partnerships

When energy prices are volatile, master limited partnership returns may follow commodity trends in the short run. Over long periods, however, MLP returns have generally exhibited a relatively low correlation with energy prices. In fact, today's volatile energy environment may be a key time to stay the course or, for appropriate investor profiles, even add to MLP allocations. Here are some key dynamics underlying the MLP market.

1 Short-term correlations can spike, but long-term correlations generally have been low.

In the near term, MLP returns can demonstrate high correlations with energy prices. When we look at the performance of energy versus MLPs over short periods, the relationship looks tight. For example, oil (measured by WTI crude futures) has endured a few short-term trends since the beginning of 2015 and in those short periods, MLPs have moved in the same direction, to varying degrees. For many clients, this relationship may feel too connected for comfort.

OPPOSITE DIRECTIONS

Over longer periods, however, the correlations historically have become much weaker. In some recent calendar years, for instance, the returns of oil and MLPs haven't even gone in the same direction — MLPs have gone up while oil has gone down, or vice versa. Generally speaking, since 2002, the longer the window of time, the less correlation we see between oil prices and MLP returns.

2 Fundamentals can improve when energy prices fall.

Most midstream MLPs are pipeline businesses that move oil and natural gas from point A to point B. Typically, they are not owners of commodities; their businesses rely instead on the volume of oil or natural gas being consumed and transported. Just as economic theory predicts, when energy prices fall, consumption often goes up. Higher consumption means higher volumes, which is generally a good thing for the "tollkeepers" that transport or store energy.

3 Rise in yields could indicate an attractive entry point for MLPs.

When MLP prices take a hit but their distributions stay steady or continue to increase, we often see a spike in yields. The yield on an MLP (distributions divided by price) has an inverse relationship to its price, so when prices go down, yields tend to rise. As of the end of August, the spread between MLP yields and the 10-year U.S. Treasury was particularly attractive, at more than 500 basis points.

During other periods when this spread has jumped, it often wound up being an attractive entry point. In the 2008 downturn, for example, MLP prices fell significantly and yields rose accordingly. In 2009, MLP returns soared. The current environment could also wind up being an opportune time to add or increase exposure to MLPs.

In the volatile commodity market, it can take a long time to reach equilibrium in the face of disruption. Clients are right to be concerned about the implications for their portfolios, but it is important to separate the effects of commodity volatility from the performance of investments like MLPs and evaluate long-term correlations within the context of an overall portfolio. With a lower long-term correlation to energy prices, attractive prospects for MLP companies with higher volumes, and the buying opportunity that often comes with a spike in yields, there is a strong case to stay the course with MLPs.

Brian Hahn is a managing director and wealth adviser at Neuberger Berman.

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Fiduciary rule headed for adoption

It will be tweaked, but will largely remain intact as it works its way through the regulatory mill

Opponents of the Department of Labor's controversial conflict of interest rule continue to turn up the political heat. On Oct. 27, the House passed legislation sponsored by Rep. Ann Wagner, R-Mo., that would prohibit the DOL from finalizing the rule until the Securities and Exchange Commission acts to extend fiduciary status to those who provide retail advice.

Advisers should not be distracted by all of the noise. Despite the daily drumbeat of industry-inspired opposition, a review of the political and regulatory landscape leads to the conclusion that the DOL fiduciary rule will survive largely intact.

On the political side, opponents can try to force delay through legislative action like the Wagner bill, or they could seek to deny the DOL funding to implement the rule once it is enacted. Both of these strategies look like long shots. There remains a lack of enthusiasm on the Senate side for legislation of this sort. Moreover, President Obama drew a line in the sand with his forceful Feb. 23 announcement supporting the rule.

VETO THREAT

Senate Republicans on their own are unlikely to achieve the 60-vote majority needed to overcome filibusters or other procedural delays. And even if they did, President Obama has threatened a veto. The bill might succeed if it is attached to must-pass legislation, but the Senate simply does not have a veto-proof majority to pass it as a stand-alone.

Legislative riders attached to appropriation bills already passed by the House that would prohibit the department from using any funding to finalize the proposal would face the same challenge.

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On the regulatory front, the DOL is in a strong position to defend the rule. It has offered ample opportunities for comment, is certain to incorporate some changes to the rule that have been suggested by industry, and has been extremely careful to avoid administrative mistakes in the rule-making process that could give opponents the opportunity for a successful legal challenge.

While prognostication can be a risky business, after weighing the political landscape and considering hundreds of pages of comment letters and hearing transcripts, I will go out on a limb and offer the following 12 predictions about the rule that will come to pass:

1. A largely intact rule will be adopted in the first quarter of 2016.

2. The final rule will include all proposed carve-outs and exemptions, as well as fiduciary coverage for individual retirement accounts and rollover advice.

3. Industry groups will challenge the rule in court, but the suit will fail to prove the DOL acted contrary to law.

4. The final rule will become effective no later than Jan. 1, 2017, possibly with phase-ins after that date.

5. Some requirements in the best-interest contract exemption will be eased or clarified, including the ability to discuss investment recommendations with a client before signing the contract.

6. The reporting of compensation based on future investment performance in the contract exemption will be eliminated.

7. The exemption will be broadened to allow advisers with compensation conflicts to serve small defined-contribution plans if they fulfill the requirements of the exemption.

CARVE-OUT FOR EDUCATION

8. The carve-out for investor education will be loosened to allow reference to specific products so long as the education does not tacitly or explicitly lead to a product recommendation.

9. Fiduciary advisers who provide advice to a plan and/or the plan's participants on a level-fee basis will also be able to offer rollover advice to the participants without having to rely on the exemption.

10. There will be significant disruption to the broker-dealer business model as firms seek to avoid the use of the exemption.

11. The DOL will abandon the idea of a so-called "low-cost, high-quality" prohibited-transaction exemption.

12. The cost and quality of personalized advice will rise; however, the higher cost of professional advice will be more than offset by product cost decreases and process improvements.

Of course, there are many other provisions in this complex rulemaking that are not addressed here. One of the biggest remaining questions is the transition plan for existing 401(k) or IRA transactions. While department officials have acknowledged that some grandfathering procedure will be required, it has offered no hint of what that might involve.

Blaine F. Aikin is president and chief executive of fi360 Inc.

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INVESTMENT STRATEGIES

Ben Lofthouse

Global dividend payers worth a look

Companies paid out a record $1 trillion last year; about 70% came from non-U.S. companies

While equity markets continue to struggle, an increasing number of financial advisers are finding value in dividend-yielding stocks.

In fact, equity income investing has become one of the best plays in the market, with quoted companies paying out a record $1 trillion in dividends last year, according to the Henderson Global Dividend Index. And relative to other asset classes, dividend-paying stocks are likely to outperform, especially outside the U.S., where the practice of returning earnings to shareholders is more common.

U.S.-CENTRIC STRATEGIES

So with about 70% of the world's dividends coming from non-U.S. companies, why do most advisers limit their equity income strategies to U.S. stocks?

Global dividend-yielding stocks are attractively valued right now and yield more, on average, than their U.S. counterparts. Additionally, dividend yields are in most cases higher than corporate bond returns, with the added benefit that many dividends are poised for growth.

And by investing globally, investors can gain exposure to a broader range of income opportunities.

U.S. and European companies have long recognized the benefit of strong and growing equity income, attracting investors with the cash flow to sustain dividends and highlight a company's underlying health.

> **THE DIVIDEND CULTURE** is spreading to the Asia-Pacific region.

The dividend culture is spreading to the Asia-Pacific region and selected emerging markets. And with an increasing number of global corporate management teams focused on strengthening balance sheets and generating good cash flow, the case for long-term dividend growth is strong.

This broadening universe provides an attractive diversification opportunity, especially as the combination of reinvested income and capital growth has led to long-term outperformance of higher-dividend-paying stocks over the wider equity market.

HIGH-YIELDING STOCKS

Yet some dividend strategies have become overly reliant on a low number of high-yielding stocks that dominate the market in a particular country. A global perspective, on the other hand, provides country diversification and optimizes opportunities at a sector level.

High-yielding equities, however, can be more risky than their lower-yielding counterparts, particularly after periods of strong market performance where stock price gains push yields down.

Remaining high-yielding stocks often are structurally challenged businesses or companies with high payout ratios that may not be sustainable. An investor simply focusing on yields or gaining exposure through a passive product such as a high-yield index tracker fund may end up owning a disproportionate portion of these companies, often known as "value traps." It also is worth noting that companies that cut dividends tend to suffer poor capital performance. It is essential to analyze the sustainability of a company's ability to pay income.

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SEASONALITY

A global approach also offers equity investors the opportunity to receive income from different sources throughout the year. For example, European companies typically pay out more than three-fifths of their annual distribution during the second quarter. North America shows the least seasonality with many firms making quarterly payments. U.K. firms tend to spread payments more smoothly than in other parts of the world, although they tend to pay larger final dividends in the spring and summer following annual general meetings. There also has been a steady flow of global stocks returning cash via special dividends and share buybacks, further supporting the case for international diversification.

Encouraged by the general health of companies worldwide and disciplined management teams focused on improving cash flow, financial advisers with a global equity income strategy will be well-positioned for long-term growth.

Ben Lofthouse is a member of the global equity income team at Henderson Global Investors.

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A target-date portfolio's target date is the approximate year when investors plan to retire or start withdrawing their money. The principal value of the investment is not guaranteed at any time, including at the target date.

Each target-date portfolio seeks the highest total return consistent with its asset mix. Over time, the asset mix and weightings are adjusted to be more conservative. In general, as the target year approaches, the portfolio's allocation becomes more conservative by decreasing the allocation to stocks and increasing the allocation to bonds and money market instruments.

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Intel sued over DC plan investments

By Meaghan Kilroy

A former Intel Corp. employee is suing officials at the company for allegedly breaching their fiduciary responsibilities by investing defined-contribution participants' retirement money in "risky and high-cost" hedge funds and private equity funds.

The lawsuit, which was filed Oct. 29 in U.S. District Court in San Jose, Calif., alleges 401(k) and profit-sharing plan participants who were invested in Intel's custom target date series and global diversified fund lost hundreds of millions of dollars on underlying hedge funds and private equity investments.

The plaintiff, Christopher M. Sulyma, is fully vested in Intel's $8.19 billion 401(k) plan and partially vested in its $6.66 billion profit-sharing plan.

'UNREASONABLY COSTLY'

"The investment committee's allocation decisions not only deviated greatly from prevailing asset allocation models adopted by investment professionals and plan fiduciaries, but also exposed the plans and their participants to unreasonably costly and risky investments in hedge and private equity funds," the lawsuit claims.

According to court documents, "Beginning in 2011, the investment committee dramatically altered the asset allocation model for the Intel [target date portfolios] by increasing Intel TDP investments in hedge funds from about $50 million to $680 million. … Similarly, the investment committee increased the diversified fund's exposure to hedge funds and private equity investments during 2009 through 2014. During this period, the diversified fund's investment in hedge funds increased from about $582 million to $1.665 billion; … the fund's investment in private equity increased from about $83 million to $810 million."

$680M Hedge fund holdings in Intel's TDPs, according to court claim

The lawsuit further claims that participants were not adequately made aware of the risks, fees and expenses associated with hedge funds and private equity, and that Intel's target date series and diversified fund underperformed peer funds.

The target date series is the largest component of Intel's 401(k) plan with $3.63 billion in assets as of April 30. The global diversified fund is the biggest option in the profit-sharing plan with $5.82 billion in assets as of the same date.

LIMITED PARTNERSHIPS

As of Dec. 31, marketable and nonmarketable limited partnership investments, which include hedge funds, commodities, emerging markets equity, private equity, credit, real estate, natural resources and energy, totaled $3.93 billion across both plans, according to the company's most recent Form 5500 filing. A further breakout was not immediately available.

Earlier this year, Intel hired AllianceBernstein to manage the target date series and diversified fund.

Stuart Odell, assistant treasurer for retirement investments at Intel, told Pensions & Investments at the time that putting AllianceBernstein in charge of the two options would relieve Intel of some of its fiduciary responsibility and streamline operations. He also said the move to external management was not related to the strategies' performance.

Mr. Odell and an Intel spokeswoman could not immediately be reached for comment by press time.

Meaghan Kilroy is a reporter with sister publication Pensions & Investments.

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BlackRock rolls out retirement income calculator

By Alessandra Malito

BlackRock Inc. has launched a retirement income tool to help advisers have the sometimes difficult conversations with clients about saving more for retirement.

Using the company's retirement income indexes — known as CoRI, which stands for "cost of retirement income" — advisers will be able to show clients visually how their current retirement savings stack up to what they'll need when they stop working.

Called iRetire, advisers can plug in information such as the client's age, current retirement savings and retirement income goals to calculate what the client can expect to have in retirement. Advisers can adjust the inputs to show different scenarios.

"One of the biggest challenges is saving for and meeting their retirement," said Frank Porcelli, chairman of wealth advisory at BlackRock.

BlackRock's iRetire joins a crowded field of retirement income calculators. Betterment came out with a retirement calculator in April, months before it launched Betterment for Business, which offers 401(k) plans. NextCapital, a robo-adviser focused on retirement, came out with a 401(k) account aggregating dashboard in September that takes all assets into account for a client.

Mr. Porcelli says iRetire is more than a retirement calculator, though.

"It is meant to be an end-to-end asset management solution for clients' retirement issues," he said. "It is a complete ecosystem for managing retirement."

31% Americans with neither retirement savings nor a pension

Mr. Porcelli said many clients don't know how much money is enough until they see it broken down per year as though it were a stream of income. Part of the problem is the fact that many employees cannot rely on their employers to help them save for retirement as they could have decades ago, he said.

"Individuals have become the sole person to drive and fund their own retirement. That's a complicated problem," Mr. Porcelli said.

"Any level of savings is good," he said. "But when you tell people that [what they saved] will provide you $9,000 a year in income, that puts on a cleaner lens."

'THERE IS A PROBLEM'

Roughly 31% of Americans have neither retirement savings nor a defined benefit plan, Federal Reserve data show. That includes 19% of people between 55 and 64.

"There is a problem," Mr. Porcelli said.

Technology tools, such as iRetire, might change that, however.

"Anything you can do to show people with some metrics where you will find yourself, those are great conversation starters," said Neil Bathon, an analyst with Fuse Research Network.

He said advisers are sometimes reluctant to deal with longer-term issues, so technology tools and platforms can assist in bridging the gap.

Rob Foregger, co-founder of NextCapital, said retirement savings tools have been around for years, but advisers haven't taken advantage of them as they should.

"I call that view and do," Mr. Foregger said. "It is one thing to create a retirement income plan and another thing to implement it and manage it on an ongoing basis."

He added that as retirement calculators improve, advisers will likely begin using them more.

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MyRA retirement savings plan launched nationwide

Bloomberg News

MyRA, the Obama administration's free, guaranteed-return starter retirement account, launched nationwide last Wednesday.

The government-backed plan is an option for the tens of millions of U.S. workers whose employers don't offer a retirement savings plan. MyRA accounts are open to anyone earning an annual salary of less than $131,000, or $193,000 if they are married and file taxes jointly. There is no minimum to open an account, as with an IRA, and no fee to open one. Payments can go into the plan automatically, directly from a checking or savings account, or from an employer's payroll system, via direct deposit. Any or all of a federal tax refund can be directed into a myRA account, which is portable from employer to employer.

A myRA (My Retirement Account) won't return nearly what a stock fund is likely to return over time, but workers face no risk of losing their nest egg. MyRAs will invest only in a Treasury security guaranteed never to lose value. Users can access the money for emergencies. In short, it operates a lot like a 401(k) — albeit without that crucial match that companies may make on employee contributions — but is effectively a Roth IRA with contributions of after-tax money that can be withdrawn, tax-free, in retirement.

3.19% Ten-year average annual return on fund on which myRA is based

The myRA.gov website notes that "interest earned is the same rate as investments in the Government Securities Fund, which earned an average annual return of 3.19% over the 10-year period ending December 2014." Over the past five years, that rate has dropped to a little over 2%, Treasury officials said, noting that "the rate is dramatically higher than what people are able to earn on savings accounts."

30-YEAR WINDOW

Savers can put away up to $5,500 a year, and those who are at least 50 by year-end can contribute as much as $6,500. The guaranteed return lasts until they accumulate $15,000 in the plan or have been in myRA for 30 years, when they will need to move the money into a private sector product such as a Roth. They're also free to move the money out of myRA and into an outside retirement product at any prior time.

"This has been a long time in coming," said Olivia Mitchell, professor of business economics and public policy at the University of Pennsylvania's Wharton School and director of the Pension Research Council. "Yet it's just a first step, and more needs to be done to enhance retirement security for an ever longer-lived population."

David John, a senior strategic policy adviser at retirement organization AARP's Public Policy Institute, said myRA is a good tool but not a solution to the "desperate need for additional ways to save for retirement." MyRA will help many people get started in saving, he said, "but people also need to be able to roll over money into a regular retirement plan, whether it's a state-sponsored plan or that of an employer." And only about half of U.S. employers offer such a plan.

Treasury Secretary Jack Lew noted at a news conference that "we have been very clear that this is a start, not a finish. People will never build up the retirement savings they need if they don't start."

Treasury officials also noted that "the goal of the program is continuous improvement" and that additional features are planned.

The administration announced its plan to start myRA in the president's State of the Union Address in 2014. MyRA has been in a pilot program with a small group of employers since late last year.

Birinyi still sees stocks going higher

October's advance in the S&P 500 erased the index's loss for the year

Bloomberg News

Laszlo Birinyi says there's more money to be made in the stock market.

"You're in a bull market, and in a bull market stocks go up," said Mr. Birinyi, the investor whose calls have come true repeatedly since 2009. "The best thing I can do right now, which I have been saying all along, is stay the course."

At the depths of a summer swoon, the president of Birinyi Associates predicted stocks would "come out OK" after a six-day rout sent the S&P's 500 Index tumbling into a correction. Since then, the gauge has rallied 11%, with the bulk of the gains coming during an 8.3% rally in October.

At the rout's worst, Mr. Birinyi said he was optimistic stocks would rebound because the causes of the correction weren't hidden. China's surprise devaluation of the yuan sparked concern that slowing growth there would spread.

"When the market went down, I thought I knew why, and therefore I wasn't nearly as concerned as if it would've gone down for no reason," he said. "If I understand it, the market does too, and they'll react and respond accordingly."

The response came from central banks, which reasserted themselves in October. The Federal Reserve kept interest rates pinned near zero, while signs of weak growth prompted the European Central Bank to hint at potential extra measures. In Asia, China unexpectedly cut its lending rate and Bank of Japan maintained record stimulus.

QUANT FUNDS BOUGHT

Another force in the rebound was buying by quantitative funds such as commodity trading advisers who operate in equity futures, according to a note Oct. 30 from strategists at JPMorgan Chase & Co. Those traders, whose selling was blamed for worsening the rout in late August, showed signs of "capitulation" in mid-October and probably amplified the move in equities, strategists including Nikolaos Panigirtzoglou wrote.

> "YOU'RE IN A BULL market, and in a bull market stocks go up."
> Laszlo Birinyi
> President, Birinyi Associates

"There is still an overhang of short positions in U.S. equity futures, which if unwound could propel U.S. equities even higher from here," they wrote. "While the position reversal by CTAs points to capitulation by bearish equity investors, the overhang of short positions in U.S. equity futures suggests that there is room for further short covering."

The October advance erased the S&P 500's loss for the year, leaving it higher by 1% as it capped a fifth straight week of gains. That's the longest rally of the year. The Nasdaq 100 Index surged 11%, at one point coming within a point of its 15-year high set in July.

DEFYING PESSIMISTS

Mr. Birinyi has defied market pessimists throughout the 6½-year bull market, writing in December 2008 that stocks had reached their lows. In September 2011, he said U.S. companies were earning too much to be dragged lower by Greece's debt crisis. The index bottomed the next month and then climbed 14% through the end of the year.

While he is hesitant to put out a specific market forecast due to uncertainty over Chinese policy and volatile oil prices, Mr. Birinyi says the direction for stocks is up. Recent events, such as Fortress Investment Group's decision to shut its flagship macro fund and a postponed public offering by Albertsons Cos., contribute to indications that that bull market still has room to run, he said.

"You don't see people closing hedge funds at a top. You don't see them postponing IPOs at market tops," he said. "My six-month forecast is higher."

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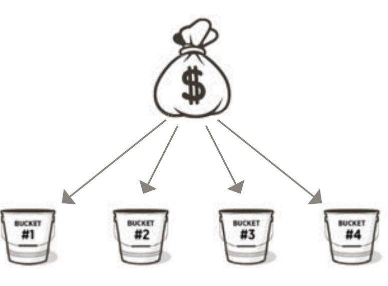

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Crowdfunding comes to client near you

Continued from Page 5

"We will be launching several [investment options] on the day that the rules allow us to go live," said Ron Miller, chief executive of StartEngine, a four-month-old crowdfunding platform that already has attracted 30,000 investors under a different provision of the JOBS Act that involves more reporting and disclosure requirements than will be required under Title III.

What StartEngine and the hundreds of similar platforms are tapping into is the interest among millennial investors to invest locally or in familiar and socially acceptable ventures.

"We know that baby boomers invest 80% for the financial return and 20% because it's helping the world, but for millennials it's the opposite way around," Mr. Miller said.

THE GROUND FLOOR

He said, however, that there is no shame in getting in on the ground floor and making a killing.

"The kinds of investments we're likely to see under Title III are going to be more on the wealth accumulation side for purpose of getting a big hit," he said. "This is the first time that 92% of the population has had a chance to get in on the ground floor, to get in on the next big thing."

New rules that allow crowdfunding platforms to give non-accredited investors access to private equity will not quite be luring them into the Wild West of alternative investing.

LIMITED BUY-IN

For starters, any deal offered will be limited to a $1 million capital raise within a 12-month period. And even though the rules deal with retail-class investors, the individual investments will be capped at between 5% and 10% of the investor's gross annual income.

$1M
Limit on capital raised within a 12-month period

It would be a mistake to shun the crowdfunding trend as a touchy-feely millennial fad, according to Marshall Saunders, co-founder and managing partner of SaundersDailey, a real estate crowdfunding platform, launched in June, that currently has four investment offerings.

"We started this so we could reach unaccredited investors because we think that ratio of appeal based on good will and performance is going to become about 50-50 in a few years," he said. "We're just waiting to hear what the new rules will be, and we'll be compliant with those."

Advisers will need to be on their toes because retail-level private equity is still a very new and evolving space. Some platforms will be operating in a manner similar to brokerage platforms, while others might be structured as investment funds.

Casey Minshew, director of investor relations at two-year-old EnergyFunders, said his platform likely will offer separate access points for accredited and non-accredited investors. Some of the complications there include prohibitions on offering investment advice to retail investors.

EnergyFunders' current accredited investor platform has a $5,000 minimum investment and 10% take of any profits, which is a structure that probably would not be allowed for retail investors.

"The two platforms will be different, but it's still not clear how we will roll out retail access," Mr. Minshew said.

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Scott Mather: A Pimco CIO said they took advantage of market pricing.

Pimco

Continued from Page 6

peers, according to data compiled by Bloomberg.

'MARKETS CALMED'

"We took advantage of market pricing that reflected extreme worry about spillovers from China and global deflation in September," said Scott Mather, a manager on Total Return and Pimco's CIO for core strategies. "As markets calmed and reassessed the probabilities with new data in October, our positions in corporate credit, mortgages and Treasuries benefited."

The $51 billion Pimco Income Fund has returned 3.6% in 2015, beating 98% of peers. It ranks in the 99th percentile for the three- and five-year periods.

While Pimco Total Return has lost assets, investors have added money to competitors such as TCW's Metropolitan West Total Return Bond Fund and the DoubleLine Total Return Bond Fund. DoubleLine's fund has returned 2.6% this year, outperforming 93% of peers, while the MetWest fund is up 0.6%, besting 45% of peers.

DFA rolls out TDFs

Continued from Page 8

wealth to managing the volatility of consumption."

The drawdown phase of retirement has garnered a lot of attention among 401(k) industry watchers.

"Advisers are spending a lot of time studying drawdown and the best ways to do that," said Barbara Delaney, principal at StoneStreet Advisor Group.

The use of TIPS is fairly common within target date fund groups, but the allocation in most doesn't exceed 10 percentage points, according to Jeff Holt, multiasset analyst at Morningstar Inc.

The Dimensional 2030 Target Date Retirement Income Fund has a 20% allocation to TIPS, 65% to global equity and 15% to global fixed income; the 2015 fund has a 75% TIPS allocation, with the remainder in equities.

'BIGGEST NUANCE'

"I think the biggest nuance [of the funds] is the heavy use of TIPS, specifically in the retirement phase with that objective of more of an LDI objective to help meet the consumption needs of investors in retirement," Mr. Holt said.

Further, the funds have what Mr. Holt referred to as a hybrid glide path, combining both the to and through strategies used in TDFs. The retirement-dated fund maintains its equity allocation for about 10 years in retirement and then becomes a bit more conservative, which is unique among TDF managers, Mr. Holt said.

There are more than 50 target date mutual fund series on the market, and although DFA is late to the game, the firm is doing something "markedly different" than the other players, which could prove useful for garnering assets, Mr. Holt said.

"ADVISERS ARE spending a lot of time studying drawdown and the best way to do that."

Barbara Delaney
Principal
StoneStreet Advisor Group

"It's not a copycat strategy. It's not trying to do what other people are already doing," he said.

DFA's fees relative to other TDF series also should be attractive to advisers, Mr. Holt said. The cost for institutional shares ranges from 21 basis points for the most conservative fund, the 2015 fund, to 29 for the most aggressive, the 2060 fund.

That compares with an average asset-weighted expense ratio of 78 basis points for other target date funds, according to Morningstar.

Ms. Delaney said DFA's strong brand among advisers could also help it win assets in the crowded TDF market.

"With DFA, you have a group of advisers that are groupies and then those who are agnostic to it," she said. "But there's definitely a very different following versus every other fund [company] out there."

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BRIDGING GENERATIONS

Pathstone builds multifamily office on internal succession planning, expertise in helping high-net-worth and ultra-high-net worth families

Pathstone Family Office was launched in 2010 to provide an array of services—investment management, tax planning, estate planning and more—to multigenerational families. At the start, the firm served 19 families; it now serves 46 families whose net worth generally ranges from $30 million to $300 million through offices in Fort Lee, N.J., Naples, Fla., and Atlanta, GA. The firm's goal is to become an institution that lasts for generations to come. Recently, InvestmentNews Content Strategy Studio discussed the firm's Secrets Behind Success—which include having the right clients, the right employee succession plan and the right service partners—with Steve Braverman and Allan Zachariah, co-chief executive officers, and Matthew Fleissig, president.

Q: How did Pathstone begin?

Steve B.: Effectively, we were a liftout from an organization called Harris myCFO. We wanted to take the business to a level of independence that wasn't possible within the ownership of the two corporate entities. So with the support of our parent company—and, importantly, with the support of our employees and the families we served—we launched Pathstone in 2010 with 19 employees serving 19 families.

Q: Your clients are families rather than individuals. What is your approach to meeting their various needs?

Allan Z.: What we've really built is a single-family office, and we sell pieces of that to our clients. A $3 billion family is not going to use a multifamily office; they're going to build their own single-family office. We've constructed what a $3 billion family would construct, which is a multi-disciplined organization of 35 to 40 professionals who provide all of the services a family needs. So our clients receive the same experience as a $3 billion family, but they only use the services they need and can afford.

Q: Your business model involves working very closely with client families. Give us an example of the kind of hands-on service you provide.

Matthew F.: We try to handle everything so that clients don't have to think about anything but living their lives. For example, Hurricane Sandy destroyed or severely damaged the homes of many of our clients. We immediately went into action, arranging for crews from insurance companies to do inspections and for cleanup crews to dry out basements. We also hired and monitored contractors to make repairs, and we paid their bills when the work was done.

Allan Z.: A client called because he had read about the release of a new 'supercar' by Bugatti. He asked if we could help him get on a list so that eventually he could get one of these cars. Through some contacts we had, we were able, within 24 hours, to find him the last one of these cars available in the world, in Vienna, Austria. When I called the client to tell him, I talked to his wife. She decided not to tell him right away, and she gave him the car for Christmas.

Q: How have you designed your business model to ensure that clients receive the kind of personal attention that they expect?

Allan Z.: In a relatively short amount of time, we have become known for delivering extraordinarily high levels of service and quality. For example, we have systems in place to make sure that when a client is communicating with the firm, they're not communicating with just one team member but with their whole service team.

Steve B.: We're frequently asked what differentiates Pathstone, and it's not only the cultural alignment or our bias to proactivity. It's also that many of our clients have come to realize, in a positive way, that there are things that they don't know and that we're there to help. They've also come to appreciate the value of having an organization of truly aligned professionals who are going to think about them—and only them—each and every day.

Q. For the most part, your service to clients spans the generations. How has that affected the business model you have built?

Allan Z.: When a family comes to us, they're choosing to outsource the back office of their family—all the inner workings of their investments, taxes and estate planning. For most families, that's a multigenerational experience. Since wealth typically is transferred from one generation to the next, we are stewards of that wealth transfer and it's incumbent on us to have a business model that has a multigenerational component to serve these multigenerational families.

Steve B.: Organizationally, we are built to serve multigenerational families. Clients look to us to care not only for their needs, but also for the needs of their future generations. It's important for them to see us as proactively involved, engaged and thoughtful about what we do for them and how we care for them and think about them every day, often taking care of issues they're not even aware of.

Q: Because of your multigenerational client base, the younger generation of your client families may relate more easily to younger members of your staff. How do you encourage and support that?

Matthew F.: Recently, when a client signed up for all of our services—accounting, reporting, tax work, etc.—he told us that when he made the decision to go with Pathstone, he was making a 30-year commitment. We can fulfill that 30-year commitment because of the succession planning already in place in which the firm's older owners have started to sell equity to our younger associates. We also provide educational assistance so our younger associates can earn their CFPs, MBAs, CFAs and CPAs. These steps, and actively involving our younger associates in our work with clients early on, allows Pathstone's younger generation to interact with our client families' younger generations.

Q: Do you have a strategy to help you locate and bring on board new people?

Steve B.: We tell all of our clients that we want to be a multigenerational organization in service to multigenerational families. There are a number of ways we get there. Obviously, we believe we've created a great environment, which helps to attract potential new employees and partners seeking to grow professionally and personally. There are multiple paths for career growth at our organization, and we're always looking to hire and bring in new people with potential.

Q: What kind of people are you looking for?

Matthew F.: We're always looking for terrific advisors who are mature regardless of their age, so that we can handle more clients. The cultural alignment has to be right so that the advisor will enjoy everything we've built at Pathstone—the system, the processes, the investment platform and everything else. That is essential.

We are very excited about our combination with Federal Street Advisors in Boston. The cultural fit is there, as well as synergies in the types of clients we serve. And we bring complementary strengths to the table. Our family office services marry very well with Federal's deep investment management experience. This merger also expands our shareholder base, particularly to those who are still relatively early in their careers—confirming the multigenerational approach both of our firms understand to be mission critical for long-term success.

Q: Of course, in addition to bringing on new team members, you also want to find new clients. How do you go about that?

Allan Z.: In five years, we've more than doubled our size, serving 46 families. Today, new clients come to us in all the ways you would hope in a professional services firm. Probably the most rewarding ones are those who come to us as referrals from existing clients. And that's where the majority have come from in the last several years.

Q: Has the day-to-day reality of Pathstone validated your original vision for the company?

Matthew F.: Absolutely. Pathstone is an exciting place to be right now. We're growing in a smart way so that we don't lose our white-glove touch or our level of client contact.

Steve B.: We founded Pathstone to liberate the business from institutional ownership so that it could maintain its long-term focus. All of our expectations and plans for the firm revolve around Pathstone maintaining that independence. There is a great deal of pride at Pathstone, and we remain excited, energized and challenged in a very positive way about keeping our founding promise of becoming a 100-year-old institution.

Q: Pathstone has worked with Pershing since before the official launch. What has impressed you about working with Pershing?

Allan Z.: It took an enormous effort to transition our 19 initial families to Pathstone in three months, and Pershing was an active partner—working day and night—to help us get that accomplished.

Q: What factors enabled Pershing to work so well with Pathstone?

Allan Z.: In many ways, Pershing's culture is exactly like ours. They are proactive, and consider things that we might not have thought about ourselves. They are also extremely client-oriented, as we are. And, just like us, Pershing is focused. They have a systematic approach to things and a group of outstanding professionals who put the client first. And not only have they learned how to run a very efficient business, they share what they've learned to help us run a better organization.

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MARK TIBERGIEN
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BEN HARRISON
Managing Director, Pershing Advisor Solutions

HOW PERSHING HELPS FIRMS LIKE PATHSTONE MEET CLIENTS' NEEDS

Pershing Advisor Solutions, a BNY Mellon company, has been part of Pathstone's remarkable story from the beginning. Mark Tibergien, CEO of Pershing Advisor Solutions, and Ben Harrison, Head of Business Development, talked about Pathstone's unique service model and Pershing's role in helping the firm grow.

THINK LIKE A BUSINESS OWNER

When advisors choose to go independent, it is important for them to think like business owners and have a clear idea of the kind of structure they should have and the people they should hire to be able to grow.

Pathstone recognized that transitioning to an independent, multifamily office was critical to meeting the complex needs of the wealthy families they serve and their future generations. We helped with that transition to independence, implementing systems and processes to help Pathstone run its business efficiently and serve their clients effectively.

CUSTODIAN AS MANAGEMENT CONSULTANT

Businesses such as Pathstone look for more from a custodian than the basics. Pershing is a business solutions provider with custody at our core. We provide robust solutions, as well as a commitment to proactive, flawless service execution. We deliver not just practice management, but business management solutions. We help our clients answer questions they might be asking themselves—about how to grow their business, operate most efficiently, attract, retain and train talented people, and manage risk.

Pathstone has grown through a commitment to succession planning and cultivation of the next generation of clients, as well as smart transactions, such as its merger with Federal Street Advisors. As Pathstone continues to evolve, we will continue to provide them the solutions and level of service that they and their family clients expect.

THE PERSHING DISTINCTION

We are committed to providing market-leading solutions and a world-class service experience to growth-minded advisors who run their practice as a business, to help them meet the needs of complex, high-net-worth clients. We offer an array of technology and investment solutions, trading in many key foreign markets, as well as access to private banking and a collaborative banking and brokerage platform solution through BNY Mellon.

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Investment-only VAs tacking on death benefits

Optional features allow for more choice amid growing sales

By Greg Iacurci

Insurance firms offering investment-only variable annuity products have been tacking on death benefit options for investors as a way to offer more choice in a growing marketplace.

Nationwide Financial and Axa Equitable Life Insurance Co. have launched IOVAs with a death benefit option this year, and Lincoln Financial Group is aiming to launch one in mid-November.

That follows the products that other firms, such as Metropolitan Life Insurance Co., Principal Financial and American International Group, introduced in 2014, according to Morningstar Inc.

"There's no downside for an insurer to issue an IOVA with an optional death benefit, provided it's optional. It gives them the ability to meet more demands from more people," said John McCarthy, senior product manager for wealth management products at Morningstar.

IOVAs, also referred to as investment-oriented or investment-focused variable annuities, are essentially stripped-down versions of more traditional variable annuities that have features such as living-benefit riders. IOVAs are meant to be a tax-deferred investment play, offering a wider array of investments and a lower price tag when compared with traditional VAs, advisers and insurance executives say.

Many IOVAs, like a standard deferred annuity, have a standard death benefit built in that returns the contract value at no additional charge. Insurers are beginning to introduce death benefit options such as a return-of-premium benefit, which come at an additional cost. Return of premium is typically the cheapest type of death benefit investors can purchase through other annuity contracts, according to industry experts.

ISTOCK

PRODUCT EXAMPLES

Lincoln, for example, rolled out its Investor Advantage IOVA in 2014. It plans a Nov. 16 debut for Earnings Optimizer, the death benefit to be associated with Investor Advantage, which will include a return-of-premium option. A spokesman declined to provide additional information because it hasn't been filed yet with the Securities and Exchange Commission.

Axa launched its Investment Edge IOVA in 2013, and this year came out with Investment Edge 15.0, which provides the option for a guaranteed minimum death benefit and a return-of-premium benefit.

Nationwide this year introduced a Destination Freedom+ IOVA with a return-of-premium option as well as one for a highest-anniversary enhanced death benefit. At death, the latter would pay out the greater of the current contract value, net payments made to the contract, or the highest contract value on any contract anniversary preceding the investor's 80th birthday.

"We feel options are good. I can get the lowest cost if I want without the death benefit, but if I want it I can pay a little extra for it," said Eric Henderson, senior vice president of individual products and solutions at Nationwide.

IOVAs have seen strong sales growth over the last few years, as overall variable annuity sales have floundered.

IOVA sales experienced 20% year-on-year growth in the second quarter of 2015, to $10.9 billion, according to an analysis by the Insured Retirement Institute. Sales were up 93.8% from $5.6 billion in the second quarter of 2011.

Overall VA sales, at approximately $67 billion as of the second quarter, were down 15.5% over the same time period.

"The flows going into IOVA products are definitely increasing, and at a pretty rapid rate," Mr. McCarthy said. He estimates growth will remain strong at least through year-end due to large carriers' having launched products recently, which likely will garner flows.

Scott Witt, owner of Witt Actuarial Services, said the IOVA death benefits give policyholders peace of mind that the worst-case investment scenario is that their heirs will get back their original investment.

"People like guarantees and downside protection ... and it's a marketing story that sells," he said. "This [return-of-premium death benefit] is just another variation of that."

Of course, that protection comes at a price, Mr. Witt said.

The Nationwide return-of-premium benefit costs 20 basis points, while the highest-anniversary option is 30 basis points, for example. MetLife's Investment Portfolio Architect IOVA has a return-of-premium benefit that costs an additional 25 basis points.

RELATIVELY INEXPENSIVE

Because the additional benefit is relatively inexpensive for clients, the ability to pass along the full principal value to beneficiaries even in down markets could be an attractive one, according to Mark Cortazzo, senior partner at Macro Consulting Group.

"That's appealing for me for pennies difference," Mr. Cortazzo said.

Mr. Witt, though, said those investing to pass on assets to the next generation represent a "small sliver" of annuity investors. If clients want death benefit protection, term life insurance may be the better play, he said.

"I don't find those guarantees to be very logically appealing," he said. "Most people with annuities are saving for their own retirement, and by definition, once they're dead they didn't outlive their assets."

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W.P. Carey looking at 3-way split

REIT exploring break into three separate businesses for investor clarity

By Bruce Kelly

W.P. Carey Inc., a publicly traded real estate investment trust, is exploring breaking into three separate businesses.

The company announced in an earnings call last Tuesday that it was actively exploring the option of creating three businesses: a U.S. net-lease REIT that would own and manage domestic commercial properties, an international net-lease unit, and an asset management company to create nontraded REITS and other alternative investment products.

"We are actively exploring their potential separation and the ability to create long-term value by allowing each to pursue distinct business strategies and what we believe would be superior opportunities for growth," chief executive Trevor Bond said on the conference call. "Our review is well under way, and we feel we have good visibility into the fundamental issues involved."

Right now, the company is essentially a hybrid, operating both as a REIT and a manager of nontraded REITs. Last year, W.P. Carey said it was retreating from selling nontraded REITs that focused on net-lease real estate, its bread and butter for years, and instead was focusing on lodging and self-storage commercial real estate, as well as looking for opportunities in Europe.

Mr. Bond declined to comment several times on the call when analysts asked about the details of the company's restructuring.

"The bottom line is we don't know what it will look like," said Paul Adornato, an analyst with BMO Capital Markets. "There are many questions about how much G&A — general and administrative — expenses each potential entity would bear. If you don't know that, it's very tough to come up with an estimate of the value of each component of the company."

Mr. Bond said details about the potential change in the company's structure would be forthcoming, particularly regarding issues such as taxes, regulation and legal matters.

"We believe that separation would provide for more focused and simplified structures that would be easier for investors to understand. We think that aligning each platform with sector-specific shareholders is desirable and that we could achieve a cost of capital most appropriate to each entity by this alignment. We think that would allow us to allocate capital in a more focused way," Mr. Bond said.

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Stifel on Sterne Agee

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pendent reps: those affiliated with Sterne Agee Financial Services Inc., and those with a firm that Sterne Agee had acquired earlier last year, WRP Investments Inc. As of June, it reported it had 736 independent contractors altogether. In contrast, it had 2,087 employee advisers, or wealth managers.

There's no doubt Mr. Kruszewski has been busy. In June, Stifel said it was acquiring the U.S. wealth management business of Barclays Plc.

In a separate interview, Mr. Kruszewski said his objective was to have independent broker-dealer margins on par with those at industry leaders such as LPL Financial and Raymond James Financial Services Inc.

That would be a lofty goal, said Larry Papike, an industry recruiter.

FEES, PAYOUTS

Mr. Kruszewski will not "get what he's shooting for on margins unless he raises fees or cuts payouts to advisers," said Mr. Papike. "If that's the case, he could lose advisers."

Another industry recruiter, Jon Henschen, speculated whether Mr. Kruszewski's comments on lower margins in the independent contractor business was an indication the group could be up for sale.

"Here it could make sense to sell the reps on the independent side because the margins are higher on wealth management," said Mr. Henschen.

Mr. Kruszewski shot down the notion of cutting payouts or selling Stifel's independent broker-dealer business. "There is no current process to sell the independent business or the Sterne Agee clearing business," he said, adding that he has had numerous inquiries from potential buyers.

"In the majority of our deals we improve margins without impacting adviser pay," Mr. Kruszewski said. "But I do make the infrastructure better through synergies," he said, adding that when advisers improve their productivity, that also improves margins.

Stifel is a growth company that has completed more than a dozen acquisitions in the past decade.

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House bill to hit DOL

Continued from Page 5

investor protection at the Consumer Federation of America and an advocate for the rule, said it already meets the standards outlined by the lawmakers, and that their principles are short on details. She criticized the legislative framework for emphasizing disclosure rather than mitigation of conflicts, and not mentioning enforcement mechanisms.

'INDUSTRY BIDDING'

"It sounds to me as though they are simply doing industry bidding by creating a best-interest standard in name only," Ms. Roper wrote in an email. "That has nothing to do with protecting small savers. It is all about protecting industry's bottom line."

The DOL proposal was released in April with White House backing and has gone through two comment periods and four days of hearings. A final rule is expected early next year so it can be finalized before the Obama administration leaves office.

Proponents say advice standards must be raised in order to protect investors from high-fee products that erode retirement savings. The industry argues the rule will significantly increase liability risk and regulatory costs for brokers, making advice more expensive to give and receive.

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Portfolio Manager Viewpoints

Looking Beyond Traditional Active Management to Help Clients Weather a Climate of Global Uncertainty

Stephen Bond-Nelson
Director and
Portfolio Manager
Allianz Global Investors

Michael Heldmann
Director and
Portfolio Manager
Allianz Global Investors

Kristina Hooper
U.S. Investment Strategist
Allianz Global Investors

Lu Yu
Director and
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On September 29, Stephen Bond-Nelson, Michael Heldmann, Kristina Hooper and Lu Yu of Allianz Global Investors joined Evan Cooper of InvestmentNews Content Strategy Studios in a recent Portfolio Manager Viewpoints webcast to discuss ways investors can manage risk and find growth, particularly in emerging markets.

Evan Cooper | Could you start by giving us a quick overview?

Kristina Hooper | We remain in a state of financial repression, with an ultralow fed funds rate since 2008 and massive asset purchases with quantitative easing. The U.S. will remain accommodative even after it starts hiking rates. As it normalizes monetary policy, capital markets are likely to normalize. We'll see more volatility, and correlations among asset classes and stocks will decrease. QE was a rising tide that lifted all boats and caused correlations to jump significantly, making it difficult for active managers to outperform.

Many investors disadvantaged themselves by moving to cash after the financial crisis. The current environment is making them favor sitting in cash again, but we need to assume risk to meet our goals.

Investors shouldn't buy a broad exchange-traded fund to gain exposure to the emerging market space but rather choose a solution that offers skilled active management. They should take advantage of alternatives, including absolute return strategies, and have exposure to a well-diversified, multiasset solution that seeks to deliver alpha via different means.

Cooper | What advice would you have for investors hesitant about emerging markets?

Lu Yu | People are concerned that the EM economies will turn sour once the Fed raises interest rates because their currencies will become even weaker. But that's not necessarily the case. And today's emerging countries are in much better shape then those in the EM financial crisis of 1997.

If you an investor with a long-term view, you should put money in EM equities: Those countries have 82% of the world population, 75% of the land and about 63% of the natural resources. They contribute almost 38% of global GDP.

Cooper | Moving to specifics, how do you dispel misconceptions about options?

Stephen Bond-Nelson | Options are a powerful tool to tailor, smooth and adjust risk-return profiles. They also can be equity replacements. Options can be sophisticated in terms of how they price but are easy to implement. And we're seeing a big increase in their adoption by institutional players and in retail markets.

Long volatility strategies benefit from sharp moves to the upside or downside and can make you a lot of money in black swan events; short volatility strategies operate in the middle of the distribution curve, with great success historically. The key is striking equilibrium between protecting on the down and generating returns in normal environments.

We use insurance policy terms to help people who are uncomfortable with options: a premium, a deductible and the underlying asset that's being protected. If you buy an option, you're protected against a move up or down, depending on whether you're buying a put or a call. As an insurance policyholder, you protect against risk. Insurers are the moneymakers over time. They are effectively the equivalent of volatility sellers.

Cooper | Talk to us about factor-based investing.

Michael Heldmann | First, it can provide more consistent, attractive returns than a passive investment in a given market would offer.

Markets are volatile, but one constant tailwind is risk premiums. You get a risk premium when you invest in equities instead of bonds, and you can expect a higher return in certain areas of the equity market than in the market overall. You can identify these areas using well-known factors such as value, momentum and quality.

In other areas and asset classes in fixed income, for example it has been a well-known technique for decades to invest in risk premiums. People have been talking about the term premium, credit premium, high-yield premium, but not about single instruments, like the bonds. But they have been talking about portfolio characteristics overall and exposure to those things.

We have transported that into equities, to build a portfolio that gives the equivalent exposure in a way that lets you harvest risk premiums and achieve a return that is above the market.

Style or factor diversification is important. You should be invested in multiple factors, diversified in the style of exposures over time. For example, in boom times, people tend to load up on things like leverage factors, because they boost earnings and make stocks look good. It's important that in the portfolio construction all risk factors are taken into account and are more or less neutralized.

Cooper | Do you believe what the government of China says about its economy?

Yu | We typically look at quite a few stats. GDP would be one of them, but we're not 100% sure of the quality of that data. Two other pieces we view as less prone to manipulation are power consumption and bank loan growth. The former is trending down and the latter is slowing.

Cooper | What's the advantage of using a fund when advisers could execute some of the strategies themselves?

Bond-Nelson | While it's true that some straightforward things could be done by just about anyone—covered call writing or individual stock put purchases¬—the logistics of managing an options portfolio would be extremely difficult without massive infrastructure.

There are some conventionally understood tools that people assume are perfect solutions for managing risk in options. At a high level, and for short periods and small moves, they're effective.

The trick is understanding how the math works, how implied volatility affects option prices, what your drawdowns can be. Putting all that together is the way you properly size your positions on the upstream, and that takes expertise.

Cooper | How does the persistence of disinflation affect the outlook for risk factors and option strategies?

Hooper | The Federal Open Market Committee says most of the things depressing inflation are transitory—the strong dollar, for example. It's difficult, but we know that in a financially repressed environment, risk assets typically outperform.

Cooper | What would each of you have be the main takeaway?

Heldmann | Factor investing can provide you with stable excess returns that make up for fees that put you on top of passive investments. And that's a smart way to choose your risks when the micro outlook is difficult to assess. Just invest and let the manager do its job.

Bond-Nelson | Take a fresh look at option strategies. There are some smart ones. We all care about risk-adjusted returns. When used correctly, option strategies can help your overall portfolio results.

Yu | If you want to get the same return that you got in the last decade for emerging markets versus developed markets, you don't buy a passive strategy. You buy an active manager who can control the exposure to the macro risks and provide you a high alpha through stock-picking capability.

Hooper | We're looking at a relatively low-return environment, in which alpha matters. Expand, but be discerning and selective. +

Watch the full webcast and get CE credit: www.investmentnews.com/globalmarketswebcast

Forgotten Gen X needs advisers

Continued from Page 1

Advisers said they see many in this group who already have made big mistakes. Some have failed to save enough to pay for their children's college educations; others have bought homes that are too expensive or co-signed loans for adult children. Advisers also report the average Gen Xer typically has signed up for too many well-marketed credit cards, and taken on monthly cell phone, day care or private-school tuition bills that stretch the family finances too thin.

"There are a lot of Gen Xers who make $200,000 to $400,000 a year and they're going broke," said financial adviser Ted Jenkin, who started oXYGen Financial seven years ago to focus in part on serving Gen X.

"THERE ARE a lot of Gen Xers who make $200,000 to $400,000 a year and they're going broke."

Ted Jenkin
Co-CEO
oXYGen Financial

CHRISTOPHER T. MARTIN

STRAPPED FOR TIME

Many in the group are strapped for time, have lost track of their personal finances and don't even read their bills, which likely come in electronically and may be paid out automatically online, too, he said.

While Gen X incomes may be rising, expectations — what its members believe they need or should be able to provide — have ramped up, compared with baby boomers'. Many more of those in Gen X are sending kids to expensive private colleges, taking exotic and posh vacations, and otherwise "chewing away at the growth of their incomes," Mr. Jenkin said.

The No. 1 goal financial adviser Philip Olson works on for Gen X clients is cleaning up consumer debt.

About 38% of responding Gen Xers said they have more debt than savings, compared with 31% of the overall population, according to the Northwestern Mutual Life survey.

"Most advisers don't get paid for helping with debt strategy," so there hasn't been much incentive to become expert in the craft, Mr. Olson said.

Ms. Goldman, Mr. Castellano's financial adviser, helps clients gain a handle on spending and "lumpy" sources of income such as sales commissions or restricted stock units, or even inheritances. Many also consult with her before deciding whether they can afford to buy a bigger house or remodel their existing home.

Gen Xers appreciate the help, but as a group this demographic is pretty skeptical of financial professionals.

About three-quarters of Gen X investors said they believe most financial professionals are just out to sell them something, according to an Allianz Life survey conducted in November 2014. Many blame the financial sector for the 2008 financial crisis, from which they may have lost jobs or value in their homes and investments, or even watched their parents' retirement accounts get crushed.

COOL WITH STOCKS

However, Gen X wasn't as traumatized as those from the younger Generation Y about investing in the stock market, according to advisers.

Ms. Goldman, founder of Tamarind Financial Planning, said they seem more willing to let their long-term investments ride than those coming after them.

"Generation X saw assets grow before the 2008-09 crisis hit and they have that positive experience," she said. "Generation Y stepped in when it was horrible, and now they don't even want to try."

Financial adviser Jennifer Harper, who started a practice in January aimed at Gen X, said she sees people who need help saving for college, an expense that will be a bigger issue for this generation because many married late and therefore will be at an advanced age when their kids are in college.

She pointed out that many Gen Xers still will be paying for college during "the retirement catch up years" that many former generations have used to sock away money the decade before retirement.

As it turns out, even Gen X's idea of retirement looks different than past generations'.

Adviser Michael Rivas, founder of Bienvenue Wealth, whose clients are 90% Gen Xers, said about half of his clients don't plan to retire in their 60s or really, ever. Instead, they want to open restaurants, or start new businesses or begin new careers.

"This is a change from the last generation, who set their clocks for 62," he said.

Mr. Rivas encourages clients to "invest in themselves ahead of time," by starting early to get any additional education and training they'll need to pursue new careers in their later years.

He also helps them figure out how to fund their dreams, whether that means coming up with a large sum to start a venture or just preparing to live without an income stream for a number of years while the next endeavor gets going.

Mr. Rivas, 49, knows of what he speaks in this area. He opened his financial planning firm five years ago after a career working on the floor of exchanges in Chicago and in other financial services positions.

He said an adviser's fee structure can make him or her more attractive to Gen X.

Transparency is the most important aspect with this suspicious group. They're on the lookout for the "gotcha moment" when they find out what they will really pay for financial help, Mr. Olson said.

Spelling out all the fees is important, and many prefer paying a monthly charge, as opposed to annual fees, because that's the way they've grown up thinking about their finances — as monthly obligations.

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Why they need help

GEN XERS HAVE POOR FINANCIAL HABITS

1. Not good at budgeting money
2. Are spenders rather than savers
3. Most likely generation to have more debt than savings
4. Unsure of their savings priorities
5. Bought homes that were too expensive
6. Think expensive family vacations are the norm
7. Don't read their bills
8. Not saving enough for kids' college
9. Have co-signed loans for adult children
10. Wary of financial professionals

KAM TAI

Financial Engines adds human touch

Continued from Page 1

lets are.

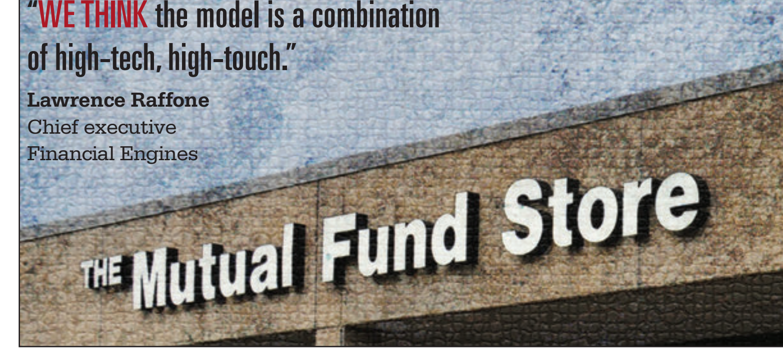
The Kansas City-based Mutual Fund Store, principally owned by private equity firm Warburg Pincus, has been expanding in recent years. Though it has been a financial planning practice since 1996 with portfolios of mutual funds, it began offering exchange-traded funds and bought an insurance company, Stuart Woodbury Insurance Inc., earlier this year.

The advisory firm's name will change to Financial Engines and locations will be Financial Engines-branded upon completion of the transaction, expected in the first quarter of 2016.

Financial Engines' shares were up 5% last Friday afternoon. The deal was announced after the markets closed last Thursday.

BIGGER PICTURE

Along with a more human touch, clients wanted to see how their retirement plans fit into the bigger picture of their finances, Mr. Raffone said.



"WE THINK the model is a combination of high-tech, high-touch."

Lawrence Raffone
Chief executive
Financial Engines

"What's hard sometimes is in mainstream America, the now prevents you from the next," Mr. Raffone said. "The idea of having a broader-based plan became apparent."

He said having a holistic financial plan is inherently important, especially to younger clients or those with smaller accounts. It's where technology and traditional advisers really work well together.

"We think the model is a combination of high-tech, high-touch," he said, adding that there are three segments of clients: those completely comfortable with being online only, those completely uncomfortable with being online only and those who want both. "We are convinced that is the model."

Laura Varas, principal at research firm Hearts & Wallets, said Financial Engines' acquisition is a step in the right direction for the robo, which did not perform well in the research firm's Inside Advice 2015 study. She said the company was too focused on retirement savings, and not the big picture.

"I encouraged them to broaden the scope," Ms. Varas said. "Young investors starting out in life, they need to be putting away money for retirement, but they have other pressing needs too."

Fred Barstein, founder and chief executive of the Retirement Advisor University, said offering a more full financial plan is great in theory, but will require a lot of work in finding the data to power such holistic advice. That will come with building strong relationships with recordkeepers, who hold client information.

BRANDING PUSH

Financial Engines also will need to work on its brand now, Mr. Barstein said. Prior to the acquisition, the company worked behind the scenes with plan sponsors, but it will have to get its name out there in order to capture more potential investors. He said branding is what made Charles Schwab & Co. and Vanguard successful when they launched their own versions of robo-advisers.

Financial Engines may be able to do this through their 401(k) plans.

"The greatest asset of defined contribution plans is not the money, it is the access to the people," Mr. Barstein said. "There are 80 million people in a defined contributions plan, which really affects 120-250 million if you think of families and children.

"It is direct access, even if all they do is look at account statements," he added. "How do you leverage that? That is the game being played right now."

The acquisition also solidifies that robo-advisers will need to leverage human advisers to stay relevant. A study by Cerulli said robo-advisers will need to grow by 50% to 60% for the next six years to attain a successful direct-to-consumer robo model.

Mr. Barstein said Financial Engine's acquisition of The Mutual Fund Store gets that message across.

"It is just incredible," he said. "It is an incredible admission that this is not just going to be done in cyberspace."

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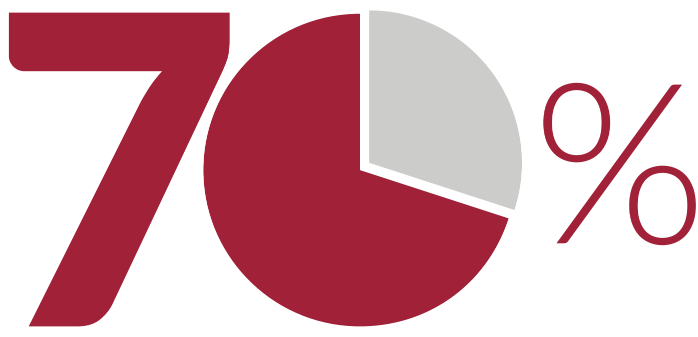

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My Independence Day

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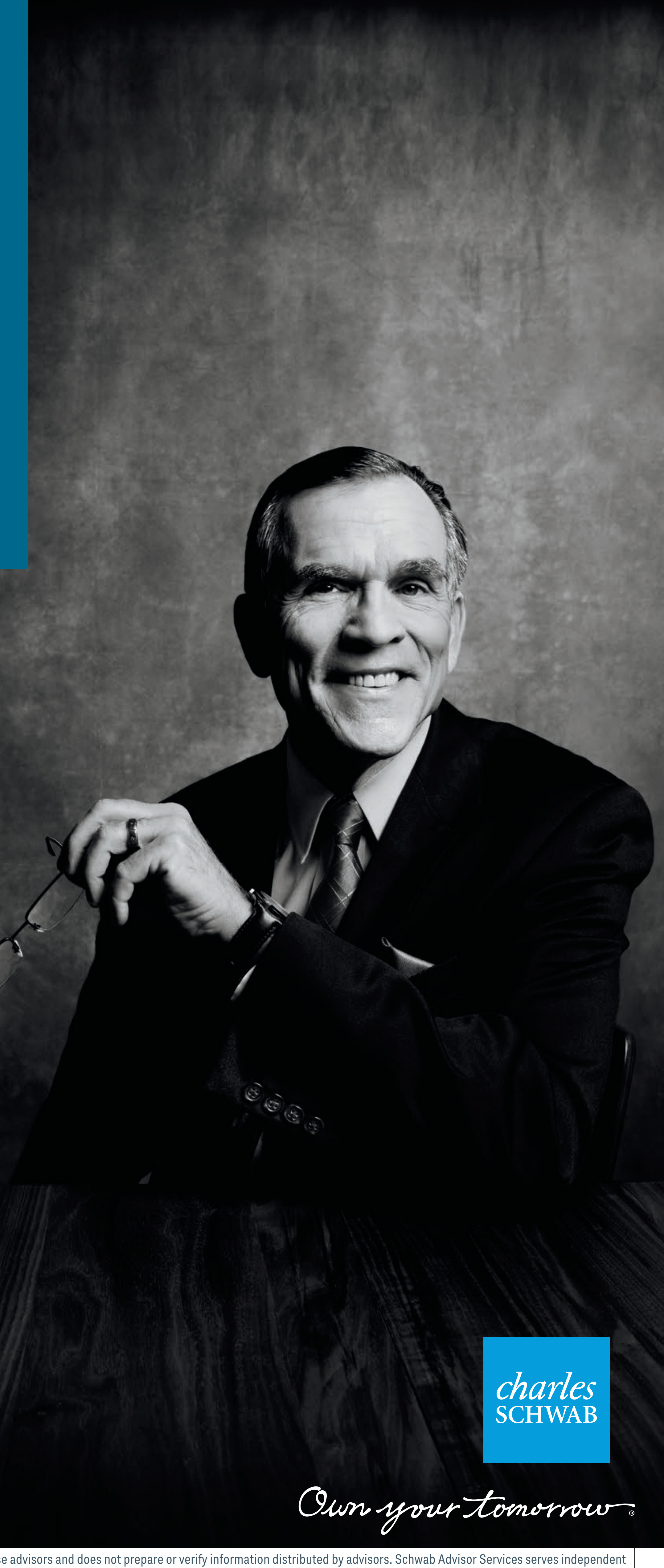

When people are entrusting you with their life savings, they have to know where your priorities lie. Your clients' trust can't go by the wayside. I became an independent advisor because I wanted to run my business in the way that I believe allows me to deliver the most value to our clients. One of the best decisions I made was choosing Schwab as our custodian. They understand what I need as an entrepreneur and have given me great guidance on everything from technology to business structure. I'm proud of our success. But I'm really proud that it's built on word of mouth. It's built on integrity.
I am Mike Piershale and this is my Independence Day.

Learn more at **advisorservices.schwab.com**

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