March 9-13, 2015

InvestmentNews®

Liquid gold
No, it's not oil. Merrill Lynch says investments linked to water could buoy returns as sources dry up.
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Devil in the details of Rubio's simplified tax plan

By Mark Schoeff Jr.

Investment advisers like the idea of streamlining the tax code but have concerns about the details of the plan put forward by potential presidential candidate Sen. Mark Rubio, R-Fla., and Sen. Mike Lee, R-Utah.

The senators introduced a proposal last Wednesday that would establish two individual tax rates — 15% for incomes up to $75,000 and 35% for earnings above that level — and would eliminate all tax deductions, except those for mortgage interest and charitable giving.

The plan also would end the estate tax and taxation of capital gains and dividends. On the corporate side of the tax ledger, it would consolidate all business taxes into a 25% rate, a ceiling that also would apply to businesses that pay taxes through their owner's personal income tax return.

TAX DODGES
Senator wants to curtail loopholes used by the rich
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"I like the simplicity," said Lisa Kirchenbauer, president of Omega Wealth Management. "We are overdue for tax reform. From a numbers standpoint, it's going to take some time to understand [the plan]."

Ted Sarenski, chief executive of Blue Ocean Strategic Capital, praised the senators for trying to address what he says is a pervasive problem he hears from callers to a local television show he's part of in Syracuse, N.Y.

CONFUSING CODE

"The average person is so confused by our tax code," Mr. Sarenski said. "[Mr.] Rubio's proposal simplifies everything so much. Simplification is a step in the right direction."

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Pay models evolve beyond 1% of AUM

Advisers look to limit conflicts of interest and serve less-affluent clients profitably

By Liz Skinner

The fee-only advice industry that emerged as brokers deserted a commission-reliant business model is now evolving, with advisers working out the best way to get compensated for their services.

Charging a percentage — usually 1% — of assets under management was once considered the "pure" way to charge clients for advice and investment management.

But critics point to potential conflicts of interest in such a structure and emphasize that it doesn't pay advisers enough to handle clients with fewer assets.

Financial adviser Konstantin Litovsky charged clients based on AUM when he started his firm in 2007. After three years, though, he concluded that the approach didn't mesh with the specialty he had developed serving young doctors and dentists.

These professionals have little in terms of assets to manage, but they have strong cash flow and some complicated needs, such as help restructuring

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STEVE DININNO

NAPFA ousts fee critic Whitehead

By Jeff Benjamin

Bert Whitehead, a veteran financial adviser who has been critical of how some of his colleagues set their fees and recently wrote a white paper on the issue, was forced to resign his position on the compensation committee of the National Association of Personal Financial Advisors.

NAPFA chief executive Geoffrey Brown said Mr. Whitehead's ouster was a board decision resulting from his sharing with the media in late January research he did for the committee.

"The decision had nothing to do with the substance of what Bert wrote — he simply did not uphold the nature of the committee's work," Mr. Brown said. "The board lost confidence in his ability to meet the demands of his assignment on the compensation committee."

CONFIDENTIALITY EXPECTED

On Feb. 19, shortly after making public his opposition to the practice of charging lower fees for cash and some bond allocations, Mr. Whitehead, founder of Cambridge Connection Inc. and an eight-year member of the compensation committee, resigned.

NAPFA board chair Robert Gerstenmeier, of Gerstenmeier Financial Group, had asked for the resignation the previous day. He did not respond to a request for comment.

Mr. Whitehead had not been operating on the committee under a formal confidentiality agreement, but "confidentiality was expected," Mr. Brown said.

Even though Mr. Whitehead's letter directly challenged the controversial practice of advisers' charging lower fees on cash and bonds, Mr. Brown said the "call to action and the sub-

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EDITOR'S NOTE

Looking for the best and brightest

Calling all wunderkinder, overachievers and both-end-of-the-candle burners.

InvestmentNews is now accepting nominations for the financial advice industry's best and brightest for our annual 40 Under 40 list. We are looking for young, up-and-coming advisers — the folks who are real shining stars and bring tremendous value to their practices.

Frederick P. Gabriel Jr.

We also accept nominations for standouts who aren't financial advisers, provided that most of their work is for the financial advisory industry.

So go ahead and nominate that academician, industry consultant or technology whiz kid you think will play a leading role in shaping the advice business over the next 20 years.

If you know someone who fits the bill — and he or she will be 39 or under on June 22 — fill out the nomination form at InvestmentNews.com/under40. You've got 200 words to make your case.

The deadline for nominations is March 31.

SELECTION PROCESS

After we've gathered all the submissions — we received more than 1,200 last year — we'll begin the selection process. Nominees will be considered for inclusion on the list by a panel of beat reporters and editors at *InvestmentNews.*

They will be assessed on four criteria: accomplishment, contribution, leadership and promise.

After we have made our choices, the honorees will be invited to an exclusive networking event here at our offices in New York City. It not only allows us to capture photographs and video of our 40 under 40, but gives this elite group a chance to get to know one another — and possibly discover opportunities to collaborate.

Finally, our 2015 Class of 40 Under 40 will be featured prominently on *InvestmentNews'* website on June 22 and in a special report appearing in our print edition on the same date.

There's a lot of exceptional young talent in the financial advice industry, and its *InvestmentNews'* privilege to be able to honor that talent and share it with our readers.

fgabriel@investmentnews.com; Twitter: @FredPGabriel

Edward Jones adds proprietary funds

Brokerage giant, long reliant on outside managers, to launch four stock funds

By Bruce Kelly

Edward Jones is expanding its lineup of proprietary mutual funds for its 12,000 brokers and financial advisers, a year and a half after the brokerage launched its first fund, the Bridge Builder Bond fund.

Edward Jones' move into the proprietary fund business runs counter to its long-stated message to its advisers not to rely on such funds but instead to use a cadre of outside money managers, long led by American Funds.

In December, Edward Jones announced the preliminary registration of four new stock funds with the Bridge Builder brand.

Last Monday, the Bridge Builder Trust requested a one-month extension of the registration period for the new funds.

$128B Client assets on Edward Jones' fee-based platform, Advisory Solutions

They are Bridge Builder Large Cap Growth, Bridge Builder Large Cap Value, Bridge Builder Small/Mid Cap Growth, and Bridge Builder Small/Mid Cap Value.

The four subadvised funds are expected to be up and running by the middle of the year and will be available to Edward Jones' clients on its fee-based advisory platform, according to a statement from the company.

NOT A MANUFACTURER

Olive Street Investment Advisors, an Edward Jones subsidiary, will be the investment adviser to the new funds. Initially, the funds are expected to have three to five subadvisers each, according to a company statement.

Steve Seifert, a partner at the firm, told *InvestmentNews* in August 2013 that the brokerage had no plans to launch funds beyond the one bond fund.

"Our intent is not to be a manufacturer of products," Mr. Seifert said.

John Boul, a spokesman for Edward Jones, said executives were not doing interviews about the new funds and pointed to a December company statement.

Jim Weddle, a managing partner, said in that statement that the funds are being created to support the growth of client assets on its fee platform, Advisory Solutions, which was launched in 2008 and has more than $128 billion in assets.

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Moore latest of LPL brass out the door

Company says leadership shifts are part of its 'transformative change'

By Mason Braswell

The brain drain at LPL Financial continued last Tuesday with the surprising announcement that the firm's well-respected president, Robert Moore, would be leaving.

News of the departure struck a sad note with many LPL advisers who knew him personally.

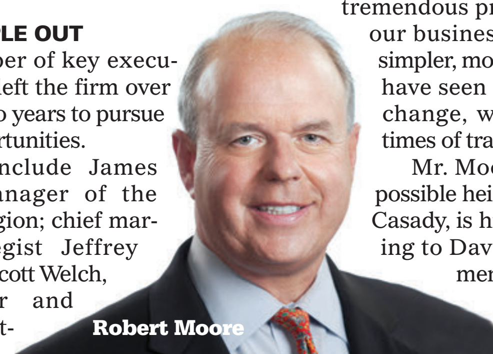
It also added another name to the list of familiar executives who have left the nation's largest independent broker-dealer in the past two years, according to John Furey, who works with a number of registered investment advisers affiliated with LPL through his firm, Advisor Growth Strategies.

"The cumulative effect is that a fair number of executives that were pretty well-known to advisers ... have left in the last year or so," Mr. Furey said. "Robert Moore did a really great job for LPL."

KEY PEOPLE OUT

A number of key executives have left the firm over the past two years to pursue other opportunities.

They include James Sorey, manager of the Eastern region; chief market strategist Jeffrey Kleintop; Scott Welch, co-founder and chief investment officer at LPL's Fortigent unit; John Guthery, senior vice president of research; Derek Bruton, managing director for independent adviser services; and Bill Dwyer, president of national sales.



Robert Moore

In an emailed statement, LPL spokesman Brett Weinberg wrote that in the past two years, "we have made tremendous progress in transforming our business to become a smarter, simpler, more personal company. We have seen our share of leadership change, which is normal during times of transformative change."

Mr. Moore, who was seen as a possible heir to chief executive Mark Casady, is highly thought of, according to David Armstrong of Monument Wealth Management.

He said he had dined

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Nuveen rethinks ETFs after abandoning them

A pioneer in the space, company returns to the table with a new plan

By Trevor Hunnicutt

Nuveen Investments Inc. is rebooting a campaign that may culminate in the company's offering its own ETFs for the first time, 15 years after it pioneered — then dropped — efforts to bring bond exchange-traded funds to market.

Nuveen's about-face, disclosed Feb. 27 in filings with securities regulators, comes as adviser-facing asset management businesses without ETFs are stampeding to get in on that market, which now manages $2 trillion in the U.S.

But unlike many others, Nuveen was early to the ETF structure. In 2000, the company asked for permission to offer index-based ETFs and was developing proposals for what could have been the first bond ETFs. Both product areas are now a boon to a number of companies, including BlackRock Inc., The Vanguard Group Inc. and State Street Corp.

MONEY PRESSURES

But Nuveen closed its ETF unit in 2002 in the face of pressure to focus on more profitable businesses, according to "ETFs for the Long Run" (Wiley, 2008), Lawrence Carrel's book about the industry's history.

"Would they be sitting on $50 billion of assets if they had stuck with it?" asked Dave Nadig, chief investment officer of ETF.com.

"Of course," Mr. Nadig said, but the market's potential wasn't clear at that point.

"It's a little hard to fault anyone for not seeing the writing on the wall," he added.

Nuveen said it has not determined yet if it wants to build the funds this time, either.

Greg Bottjer, who leads Nuveen's product development for retail mutual funds, said the company is exploring possibilities to add to its product lineup, which includes mutual funds and ETFs run in collaboration with State Street.

"The active ETF market is much further advanced," Mr. Bottjer said. "There's a lot more familiarity, comfort and exposure to active ETFs,

Continued on Page 21

Merrill to advisers: Get water

Resource may benefit from long-term trends, values-based investing

By Trevor Hunnicutt

A top strategist at Bank of America Merrill Lynch is asking its 14,000-plus financial advisers to consider an alternative asset to buoy sinking commodity returns.

Water may not be listed on the New York Mercantile Exchange alongside traditional commodities such as crude oil, gold and silver, but Merrill's Mary Ann Bartels said investments related to the resource may become as important as energy and precious metals.

Much of the world's water is either not potable or unreachable, yet clean water is a precursor to economic growth in developing economies, for uses including energy generation and agriculture.

"It's a scarce commodity," said Ms. Bartels, Merrill Lynch's chief investment officer of portfolio solutions for U.S. wealth management.

She cited figures from the World Health Organization and Unicef suggesting that 2.5 billion people lack access to proper sani-

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GETTY IMAGES

The negative returns from Social Security

Highlight need for creative claiming strategies

Mary Beth Franklin
On Retirement

Lifetime payroll tax contributions will exceed the amount of Social Security benefits many of today's workers will receive in retirement, despite the fact that today's retirees tend to live longer than previous generations.

The higher the income, the lower the return on payroll taxes, according to a recent article in the winter 2015 issue of the Journal of Retirement.

While some may argue the research is proof that Social Security is a bad deal for high earners, it gives financial advisers one more reason to encourage clients to optimize their claiming strategies.

After all, clients have paid a lot of taxes over their careers. They should make sure they maximize their benefits through appropriate creative tactics, such as file and suspend or filing a restricted claim for spousal benefits.

Sylvester Schieber, author of the article, "Social Security costs in the larger context of retirement saving," agreed.

"I think there is a pervasive sense that Social Security is a super deal that links back to an earlier era that is now past," said Mr. Schieber, a former member of the Social Security Advisory Board and an independent benefits consultant retired from Towers Watson.

"I suspect that many folks would be dumbfounded if they realized that the net cost of participating in Social Security for an average worker today is roughly five years of their lifetime earnings," he said.

MAX GETS HIGHER

Mandatory participation in the Social Security system gets more expensive for higher earners as the maximum amount of wages subject to payroll taxes rises almost every year.

For 2015, the first $118,500 of earnings is subject to the 12.4% payroll tax, which is evenly split between employers and employees, to fund Social Security retirement, disability and survivor benefits. That's up 1.7% from the maximum $117,000 taxable wage that was in place last year.

Mr. Schieber's research did not

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ARCP reports ‘weakness’ in financial reporting controls

Finally gives Q3 ’14 earnings, revises key figure downward

By Bruce Kelly

The audit committee for troubled traded real estate investment trust American Realty Capital Properties Inc. said last Monday that it had found “certain material weaknesses in the company’s internal controls over financial reporting and its disclosure controls and procedures.”

The committee also reported that “certain payments by the company to ARC Properties Advisors and certain of its affiliates were not sufficiently documented, or otherwise warrant scrutiny,” according to a company statement. ARCP has recovered $8.5 million of the payments deemed “inappropriate.”

INAPPROPRIATE

In its filing with the Securities and Exchange Commission, ARCP did not identify any executive who received inappropriate payments. Nicholas Schorsch was chief executive of ARC Properties Advisors, the REIT’s former manager, from its formation in November 2010 until the company became self-managed in January 2014, according to its 2014 proxy statement.

> “CERTAIN PAYMENTS ... were not sufficiently documented, or otherwise warrant scrutiny.”
>
> **Audit committee,** American Realty Capital Properties

The information was part of ARCP’s earnings report for third-quarter 2014, released last Monday after being delayed in the fall. The company also restated its results for 2013 and for the first half of 2014.

ARCP said adjusted funds from operations — a key figure for the company — was overstated by 20 cents a share in 2013 and by 10 cents a share for the first half of 2014. It did not reinstate its dividend and will address that later this year, when it has a new management team.

In late October, the company revealed a $23 million accounting error in the first half of 2014 that was intentionally uncorrected. Two executives resigned at the time; in December, the company’s chairman, Nicholas Schorsch, and CEO, David Kay, also resigned.

The audit committee did not identify any material changes relating to ARCP’s real estate ownership, rental revenue or fundamental business operations. The investigation did not result in changes to the financial statements or operations of the Cole Capital-sponsored nontraded REITs.

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[3] Service Quality Measurement (SQM), 2013.

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RIA values are killing new deals

As prices soar, a few consolidators back away from purchasing

By Mason Braswell

Are prices for RIAs becoming extravagant?

At least two well-known names in the acquisition business, United Capital and HighTower Advisors, have backed away from buying established registered investment advisers. They cite, in part, the high cost of the transactions.

“The valuations of RIAs have been methodically increasing since the stock market decline in 2008, and we’re probably slightly above the historical average of the last dozen years,” said David DeVoe, whose firm, DeVoe & Co., conducts transition planning for RIAs.

“That’s driven by the stability of the economic recovery and because … RIAs are demonstrating that they can continue to win new clients,” Mr. DeVoe added.

Valuations vary widely, but about two times revenue has been considered a fair price, depending on the average age of clients, revenue and other factors. But those valuations have started to come with added premiums.

In one prospective deal with United Capital, an RIA with about $2 billion in assets under management was asking for four times revenue, according to Matt Brinker, senior vice president of acquisitions at United Capital.

‘INCREDIBLY RICH’

“I just don’t know who, at those levels, will pay that premium,” Mr. Brinker said. “Generally, valuations continue to be incredibly rich.”

Shifting from acquisitions to focus more on recruiting has been part of the firm’s plan since its founding in 2006. But it makes sense now, given the cost of capital and the need to issue new stock to owners of acquired firms, which dilutes the value of United Capital shares in the short term.

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WESTERN ASSET

(WAPSX)

Western Asset Core Plus Bond Fund

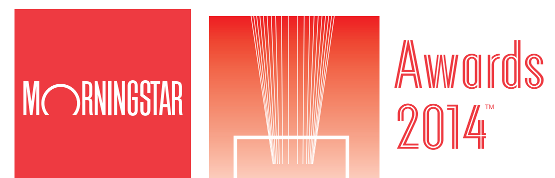
(Among 913 Intermediate-Term Bond Funds)

(WACSX)

Western Asset Core Bond Fund

(Among 913 Intermediate-Term Bond Funds)

Overall Morningstar Ratings, as of December 31, 2014. The ratings are based on risk-adjusted returns and are derived froma weighted average of the performance figures associated with a fund's 3-, 5- and 10-year (as applicable) rating metrics.



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VIEWPOINT

EDITORIAL

Catch the impact investing wave now

ADVISERS worth their salt — or the fees their clients pay them — rightly consider themselves leaders. Most pride themselves on being able to answer nearly every question from clients. These advisers know their clients deeply and provide investments that match their goals and dreams. They come up with ideas that clients may not have heard of before. These are the top performers and industry leaders.

That's why it was surprising to find that most advisers remain agnostic about impact investing, even while client demand grows.

As Liz Skinner reported in her cover story March 2, a survey by First Affirmative Financial Network of about 1,900 advisers who don't specialize in socially responsible investing found that nearly half offer or have offered an impact investment option; almost 70% of those said they did so because clients asked for it.

It's good to respond to clients, but better to be proactive.

CAN'T BE IGNORED

The growing interest in socially conscious investing cannot be ignored. From 2003 to 2012, SRI assets in the U.S. rose 54%, to $3.31 trillion, according to a report from the Forum for Sustainable and Responsible Investment. It also said U.S. sustainable, responsible and impact investing assets under management reached $6.57 trillion at the beginning of 2014, up 76% from 2012. That total accounts for nearly 18% of the $36.8 trillion in assets in U.S. funds.

Globally, impact investing, a subset of SRI, was forecast to rise 20% last year, to $12.7 billion, according to a report from the Global Impact Investing Network.

Laurence Fink, president of BlackRock Inc., recognizes how important impact investing has become.

"Clients are looking to measure the returns on their investments both by the societal and financial outcomes they can help create," Mr. Fink said last month, when his company launched a business unit to house its $225 billion in values-based strategies and develop more products.

From money managers to custodians to broker-dealers, firms are offering products and platforms that give advisers the access they need to these strategies.

Some advisers — perhaps ones unwilling to put in the effort required to offer appropriate impact investing options — argue performance to explain why these products don't make sense.

TWO VITAL constituencies — women and millennials — have embraced SRI.

But that's a bogus claim. Simply put, SRI does not underperform traditional investing.

Last year, TIAA-CREF Asset Management picked five widely known U.S. equity SRI indexes with track records of at least 10 years and compared their returns with those of two common U.S. equity indexes, the Russell 3000 and S&P 500. It also looked at volatility and risk-adjusted returns. The result?

"Our analysis found no statistical difference in SRI index returns compared to the two broad market benchmarks," its report said. "SRI can achieve comparable performance over the long term without additional risk, despite using a smaller universe of securities meeting [environmental, social and governance] criteria."

If performance isn't enough, advisers should consider another important point: Two constituencies vital to ensuring the long-term success of your firm — women and millennials — have embraced SRI.

In findings from its annual survey of U.S. investors, the Center for Audit Quality reported last October that 40% of women are inclined to invest in companies that operate in a socially or environmentally responsible way, versus 29% of men.

And Sallie Krawcheck, speaking late last year to Progressive Asset Management, said: "After years of dismissing values-based investing as a fringe activity, I have changed my view. It has moved from its early days of having to give up return in order to invest one's values to something that can be value-enhancing."

Certainly, finding the right investments — be they funds, companies or specific projects — takes hard work, and the due diligence is no cakewalk. But doesn't it make sense for you to be ahead of this wave? Because it's not rolling back anytime soon.

Letters

IAA has online tool to contact legislators

I am writing to respond to the *InvestmentNews* editorial "In unity there is strength" (Feb. 9).

I serve on the board of governors of the Investment Adviser Association as vice chairman and chairman of the IAA's government relations committee.

First, I heartily endorse your call to advisers to step up and get in the game, and urge you to repeat it regularly.

The IAA has been using an online tool (available in the advocacy section of investmentadviser .org) to connect advisers with their legislators for several years. We are judicious in calling for mass letter-writing campaigns from our busy members, but that capability was instrumental in the failure of the Financial Industry Regulatory Authority Inc.'s self-regulatory organization bill to get out of the House Financial Services Committee in 2013.

I wish we had more money to spend on lobbying (and we are working on that), but at least as important as dollars is crafting positions and messages that are reasonable, responsible and focused on the common goals of our industry and of legislators and regulators, such as robust oversight of the advisory profession by the Securities and Exchange Commission.

Working with coalitions and other industry representatives (including financial planning organizations and major custodial firms) has enabled us to fight above our weight and have an impact on key policy issues.

We value the in-depth, insightful coverage of RIA issues that *IN* provides. Your encouragement for advisers to get more involved in advocacy is greatly appreciated.

Jonathan Roberts
Chief compliance officer, senior vice president
Klingenstein Fields & Co.
New York, N.Y.

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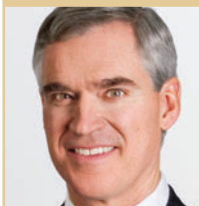
VIEWPOINT

Seeing through the ETF argument in favor of transparency

Transparency matters. It promotes marketplace competition, supports better investor decision-making and exposes suspect market practices. As Supreme Court Justice Louis Brandeis famously observed, "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."

Proponents of exchange-traded funds cite transparency as a key benefit of those funds. As the argument goes, they are more transparent than mutual funds because ETF holdings are typically available daily, whereas mutual fund holdings are normally disclosed monthly or quarterly.

OTHER VOICES
Tom Faust



This view overlooks two important facts: Mutual funds offer greater cost transparency than ETFs, and real-time holdings disclosure can harm shareholders by facilitating front-running of fund trades.

MICHAEL MORGENSTERN

COST TRANSPARENCY

The cost of investing in a mutual fund or ETF has two main components: the cost to enter and exit positions, and the ongoing cost of ownership.

The annual cost of owning a mutual fund or ETF is its total expense ratio. That is calculated and disclosed in the same manner for both, so there's no advantage there either way.

But entry and exit costs are a different story. Because all mutual fund transactions take place at net asset value, plus or minus a disclosed sales charge when applicable, investors can always measure the cost to enter and exit their mutual fund positions.

Most ETF investors can only guess their trading costs. They can see what they pay in commissions, but that's only one element of ETF trading costs. The difference between trade execution prices and underlying portfolio values is often more significant.

ETF shares trade with no fixed or disclosed relationship to either end-of-day NAV or contemporaneous portfolio values. The intraday indicative values (IIVs) disseminated every 15 seconds throughout the trading day are, at best, crude indicators of current value.

Unlike NAVs, determined at the end of each day, IIVs are frequently based on stale price data, are not subject to uniform calculation standards and may be prone to error because no responsible party stands behind them.

Further, the widespread belief that market forces cause ETFs to always trade close to underlying portfolio values may be misguided.

A recent academic study by Antti Petajisto, "Inefficiencies in the Pricing of Exchange-Traded Funds," concluded that "the difference between [an ETF's] share price and the value of the underlying portfolio is often economically significant, indicating that the unsophisticated investor may face an unexpected additional cost when trading ETFs."

Leaving ETF investors in the dark about their true trading costs positions them to make poor investment decisions, including trading too much. Even worse, not knowing the value of what they trade sets up ETF investors to routinely get their pockets picked by more-informed market participants who trade against them.

> **MUTUAL FUNDS** offer greater cost transparency than ETFs, and real-time holdings disclosure in ETFs can harm shareholders because of front-running.

PORTFOLIO HOLDINGS

On the issue of portfolio holdings disclosure, do most investors value the ability to examine their funds' holdings daily, versus monthly or quarterly?

A recent investor survey conducted by the consulting firm Naissance suggests not. In the Naissance survey, only 13% of investors said it's important for full holdings to be disclosed every day.

One audience is keenly interested in real-time disclosure of a fund's holdings: front-running traders. Armed with daily holdings and a history of fund trading patterns, a front-running trader can learn to anticipate a fund's future trading. By trading ahead of the fund, the front-runner can profit at the fund's expense, driving up fund trading costs and undercutting shareholder returns.

To avoid front-running risk, most active managers have not introduced their leading strategies as ETFs, thus depriving their investors of the performance and tax advantages an exchange-traded product structure can provide.

NEW FUND TYPE

In December 2014, the SEC granted Eaton Vance Corp. and related parties exemptive relief to permit the offering of a new type of actively managed ETP called exchange-traded managed funds.

Exchange-traded managed funds will be the first active ETPs to provide trading cost transparency, by using a new trading approach that directly links all trading prices to NAV, and protection from front-runners, by disclosing portfolio holdings monthly or quarterly like mutual funds.

Because exchange-traded managed funds will not disclose their holdings daily, they are sometimes described as "less transparent" than ETFs. This ignores the fact that they offer greater cost transparency than ETFs and avoid the potential downside of too much holdings disclosure. That's not less transparency, it's better transparency.

ACTION STEPS

How can existing exchange-traded products improve their transparency? Here are three ideas:

- Establish standard protocols for the calculation and dissemination of IIVs. To the greatest extent possible, IIVs should be determined in the same way and be subject to the same standards as NAVs.
- Improve reporting of investor trading costs by including on sponsors' websites data comparing intraday trading prices to contemporaneous IIVs and end-of-day trading prices to NAV.
- Increase prospectus disclosures of front-running risks. The myth needs to be debunked that transparency in real-time portfolio holdings is unambiguously good for investors.

Over the past 20-plus years, ETPs have provided tremendous benefit to fund investors. Following these recommendations for better transparency will bring even greater investor benefit in the years ahead.

Tom Faust is chairman and chief executive officer of Eaton Vance Corp., developer of NextShares exchange-traded managed funds.

529 benefits go beyond college savings

Discussions can cover other family issues, like estate planning

By Liz Skinner

Advisers who help clients recognize the advantages of Section 529 plans — beyond saving for college — stand to gain business benefits.

The tax incentives of 529 college savings plans are the most obvious reason to suggest that clients with children they expect to put through school consider the plans. Most states offer benefits beyond tax-free earnings to citizens in their own plans, and certain states offer benefits for investing in any state's plan.

"The 529 plans are the most generous tax provision ever passed by Congress," Peter Mazareas, a member and former chairman of the College Savings Foundation, said at the foundation's annual conference last week in Austin, Texas.

$248 BILLION

Roughly $248 billion is invested in about 12 million 529 accounts, including prepaid tuition plans, according to figures released Monday by the College Savings Plans Network.

A big-ticket item most financial advisers don't discuss with clients is the role 529 plans can play in estate planning, Mr. Mazareas said.

> "THE 529 plans are the most generous tax provision ever passed by Congress."
>
> **Peter Mazareas**
> Former chairman
> College Savings Foundation

A couple can put $140,000 in a student's 529 without the recipient's owing any tax on that sum, and it takes that amount out of the estate. The benefit is equal to five years of the couple's tax-free gifting allotment of $28,000 per year.

The accelerated gifting benefit is especially attractive to parents and grandparents because clients still control those assets, Mr. Mazareas said. The money can always be pulled out of the 529, he said, with the clients owing tax only on the earnings.

Another benefit is new this year.

The U.S. Congress approved a new type of 529 plan late in 2014 that will help individuals or couples save money to cover the costs of caring for a disabled child. Up to $14,000 a year can be saved in these accounts, and earnings will not be taxed as long as the proceeds are used for the beneficiary's qualified disability expenses.

CLAWBACKS A FACTOR

To date, most states are still determining how to offer these accounts, according to Andrea Feirstein, managing director of AKF Consulting Group.

State Medicaid clawbacks will factor into the value of these plans, Ms. Feirstein said.

In addition, advisers can position the 529 as a way to invest not only in children's education but in their broader progress through life.

Studies have shown the more than $1 trillion in student loans coincides with young Americans' postponement of marriage, home ownership and having children. The debt burden also suggests a less prosperous future.

Research shows that young adults who graduated from college without incurring student debt have an average net worth of $64,700, seven times the $8,700 of the average household headed by college-educated young adults with such debt, according to Chris Lynch, senior director at TIAA-CREF and a panelist at the conference, citing Pew Research Center data from last May.

Advisers should discourage student loan debt by encouraging saving for college, Mr. Lynch added.

Discussions about college planning also can provide specific business benefits for financial advisers.

BETTER RELATIONSHIP

Helping to resolve the problem of covering such a significant expense endears an adviser to clients, according Mr. Mazareas.

"It creates a better relationship with clients and engages the whole family," he said.

Advisers also can use college planning to increase the interest of a spouse who is less inclined to be involved in investment planning, Mr. Mazareas said.

And those who interact with the students themselves have a better chance of holding onto assets when they are passed down, he added.

Of course, boosting assets is always a good reason to bring up college planning.

The nation's adviser-sold 529 plans pay advisers a fee on assets, but half a dozen of those plans offer an adviser share class without the fee. Advisers who aren't compensated by commission can use those plans or recommend clients invest in a direct-sold 529 plan without the fee, and include those assets within the client's total wealth they help manage.

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Senate report calls for curtailing tax dodges used by the rich

By Mark Schoeff Jr.

The top Democrat on the Senate tax-writing committee called last Tuesday for curbing complex investment tactics that help high-net-worth investors lower their taxes.

A report released by the Democratic staff of the Senate Finance Committee outlines several investment instruments, including options, derivatives and swaps, that can be used to skirt "tens of billions of dollars" in taxation. It asserts that reining in those practices through legislative and regulatory changes would make the tax code fairer.

"The fact is that tax rules and Treasury guidance have failed to keep pace with the multiplying varieties of tax avoidance strategies that can be used to shelter income from taxation," the report states.

The document "sheds light on some of the most egregious tax loopholes around," Sen. Ron Wyden, D-Ore., ranking member of the committee, said at a hearing on Capitol Hill.

"Sophisticated taxpayers go out and hire lawyers and accountants to take advantage of these dodges," Mr. Wyden said. "When you hear about these loopholes, I'm sure the working-class person just gets more frustrated about what's happening here in Washington [and] wants reform."

Ron Wyden: "Sophisticated taxpayers go out and hire lawyers and accountants to take advantage of these dodges."

GETTY IMAGES

It's unclear whether the regulatory fixes the report recommends will be pursued during the final two years of the Obama administration. The proposals also face uncertainty as a Congress led by Republican majorities in both the House and Senate considers broad tax reform.

USE OF DERIVATIVES

The report highlights tax strategies that were identified by the Joint Committee on Taxation at Mr. Wyden's request.

One involves so-called collars, or options, that enable an investor to lock in capital gains but avoid associated taxes. Others include timing the sale and repurchase of securities to avoid capital gains taxes, and using derivatives to convert ordinary income to capital gains and vice versa. The report also addresses using deferred compensation to lower the taxes paid by corporate executives.

Using derivatives in a portfolio can lead to a different tax bill than one for an investor with positions in the same underlying assets, the report states.

"Differences in tax treatment of economically equivalent portfolios may allow taxpayers to some extent to elect the timing, character or source of income for tax purposes that is most advantageous," the report states. "Inefficiencies and inequalities arise when economically equivalent transactions are taxed in different ways."

The complex financial transactions that can help the wealthy sidestep taxes are unfair to workers who pay most of their taxes through levies on wages, Mr. Wyden said.

"For people having a hard time or just making their way as best they can, it must feel like the tax system is rigged to make the other guy's climb up America's economic ladder easier than theirs," Mr. Wyden said in prepared remarks.

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Gross plans to trade for another few years

Bloomberg News

Bill Gross, the money manager who jumped to Janus Capital Group Inc. in September from Pimco, the bond giant he co-founded, said he intends to keep trading for the next two to four years to prove he can still beat the market.

"I wanted to show clients and the world, to the extent that they're interested, that I can continue to produce a track record like I did at Pimco," Mr. Gross said in a Bloomberg Television interview. "I won't have five to 10 to 15 years leeway like I had at Pimco to do that, but certainly for the next two, three, four years. I'm a very competitive person, and I like to post numbers that are better than the market and better than the competition."

BOND KING

Mr. Gross, 70, became a billionaire and earned his reputation as the mutual fund industry's bond king by building Pacific Investment Management Co. into a $2 trillion money manager at its peak, with some of the highest returns in the business.

The Pimco Total Return Fund, which he managed until he left, ballooned to $293 billion in April 2013, before its performance faltered and clients began pulling out money amid concern that interest rates would rise.

Withdrawals accelerated when Mr. Gross left Pimco after losing a power struggle with management. Pimco Total Return's assets had fallen to $134.6 billion as of Jan. 30.

Mr. Gross started running the $1.5 billion Janus Global Unconstrained Bond Fund for the Denver-based company on Oct. 6. Since then, that fund has been mostly flat, trailing 54% of its peers, according to data from Chicago-based research firm Morningstar Inc.

> "I WANTED TO SHOW ... that I can continue to produce a track record like I did at Pimco."
>
> **Bill Gross**
> Fund manager
> Janus Capital Group

Mr. Gross has invested more than $700 million of his own wealth in the Janus unconstrained fund. In the Bloomberg interview, he said he joined Janus with a smaller, more flexible fund to show that he could once again establish a top mark.

Discussing his outlook for U.S. interest rates, Mr. Gross said the Federal Reserve may be conservative in its approach over the next two years. A 0.25 percentage point rise may be coming in June, he added, with 2% the likely top in the Fed's rate-raising cycle.

Vanguard to launch a liquid-alternatives fund

Will be made available to advisers through existing fund of funds

By Jeff Benjamin

The liquid-alternatives market has received an unlikely endorsement from low-cost indexing stalwart The Vanguard Group Inc.

Some money managers and financial advisers say the fund giant's registration Feb. 27 for the Vanguard Alternative Strategies Fund is proof that real diversification can't be achieved without an allocation to alternatives.

"It's about time a firm like Vanguard woke up and realized a properly managed portfolio has to have alternatives," said Ed Butowsky, managing partner as Chapwood Capital Investment Management.

"They are setting things up where all their investors will have an opportunity to have a well-balanced and diversified portfolio," Mr. Butowsky said. "No matter how big or small you are, your money should be managed the same way."

Despite initial reactions to Vanguard's move into an area that would seem to contradict many of its long-stated principles about fees and active management, the company isn't jumping headlong into liquid-alts mutual funds.

> "YOU HAVE to think about this as an active proposition and an attempt to add value."
>
> **John Ameriks**
> Head, quantitative equity group
> Vanguard

For now, access to the new fund by financial advisers and individuals will be possible only through the Vanguard Managed Payout Fund, a fund of funds designed to provide investors with a 4% annual payout, typically in retirement.

MAY LAUNCH

The multialternatives fund, which is expected to launch in May, will compose 10% of the Managed Payout Fund, which includes the Vanguard Market Neutral Fund (VMNFX) and the Vanguard Global Minimum Volatility Fund (VMVFX), along with some index funds.

Through Vanguard Institutional Advisory Services, institutional investors will be able to invest directly in the new liquid-alts fund.

John Ameriks, a Vanguard principal and head of the quantitative equity group, said even though the multialternative fund is a new direction for Vanguard, alternative strategies have always been part of the objective of the Managed Payout Fund, which his team manages.

"I'd love for people to be able to read the original prospectus that was filed in 2008 [for Managed Payout], because our goal is to combine strategies and correlations," Mr. Ameriks said. "You have to think about this as an active proposition and an attempt to add value, and doing it in a way that dampens volatility. This whole effort is designed to introduce another tool into [the fund of funds] that will enable us to do that."

Regardless of whether the prospectus has always made it possible, that Vanguard is launching a liquid-alts fund to help diversify its $1.6 billion Managed Payout Fund is generally interpreted as support for liquid alternatives.

"Vanguard built a firm based on low fees and indexing, and now they believe you need to have these alternatives; that's telling, and it's precedent-setting," said Bradley Alford, chief investment officer at Alpha Capital Management.

Jason Kephart, a fund analyst at Morningstar Inc., said Vanguard quietly backed its way into liquid alts through the 2007 purchase of its market-neutral fund from Charles Schwab & Co. That fund was subadvised by outside managers until early 2011, when Mr. Ameriks' team took over the portfolio.

"If I have any concerns about the new fund, it would be that the quant-equity group has a lot of experience in equities, but I don't know how much experience they have beyond that," Mr. Kephart said.

> **1.1%**
> New fund's expense ratio — high for Vanguard but low in the space

The new fund's 1.1% expense ratio, though high for Vanguard, is cheap in the liquid-alts category. Most multialternative funds charge over 2%, according to Mr. Kephart.

"When this fund launches, it will effectively be the cheapest or one of the cheapest in the multialternative fund category," he said. "I would be surprised if Vanguard said 'no' to financial advisers who wanted to access the fund directly."

According to Vanguard spokesman David Hoffman, adding the multialternative fund to the Managed Payout Fund will increase the expense ratio for the fund of funds to 42 basis points from 40 basis points.

"Costs are coming down for alternative investments, and this [move by Vanguard] is the second leg," said Thomas Meyer, chief executive of Meyer Capital Group.

"The ETFs are the disrupters, and Vanguard is the next phase," Mr. Meyer said. "Fee compression is everywhere, and you're seeing even high-net-worth investors banging the drum to get hedge funds to start cutting fees."

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Tuesday, March 24, 2015
4:00pm - 5:00pm ET

InvestmentNews Research and our panel of industry experts will highlight the latest trends in technology spending and implementation – and ultimately how top firms are generating exceptional returns on their technology investments.

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Tuesday, March 31, 2015
4:00pm - 5:00pm ET

Several years of strong performance have made it harder to find value in fixed income. And recently, a stronger dollar has weighed on international bond returns, raising doubts about the benefits of global diversification. With central bank policy diverging and volatility rising, now is not the time to abandon a globally diversified approach to fixed income. But greater selectivity will be required.

Join a conversation with Ted Wiese, Head of the Fixed Income Division at T. Rowe Price, and Jim Cronin, the firm's Head of USIS Financial Advisors – Broker/Dealer, as they answer questions on the minds of Financial Advisors and share their views on what lies ahead in this challenging fixed income environment.

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T. Rowe Price Investment Services, Inc.

InvestmentNews

Disclosures show details behind Schwab's robo-adviser offering

By Trevor Hunnicutt

Look under the hood of Charles Schwab Corp.'s robo-adviser and you'll find a good amount of cash, as well as the handiwork of Rob Arnott.

In the digital investment offering it plans to unveil soon, Schwab will make extensive use of index-based investment strategies popularized largely by Mr. Arnott, according to an *InvestmentNews* analysis of disclosures made by the brokerage.

Schwab Intelligent Portfolios — the company's first big push into digitized wealth management and investment portfolios — is scheduled to launch this month.

In an extensive set of disclosures about the fund-selection criteria, Schwab has given its first indication of how it will build portfolios for clients of the service (think passive), which products it will use (think exchange-traded funds) and how much it will cost investors (it's complicated).

Neither Mr. Arnott's name nor that of his firm, Research Affiliates, appears in the disclosures. But among the more startling revelations is that Schwab will make substantial allocations to a range of proprietary products that rely on indexes developed and promoted primarily by Research Affiliates.

A Schwab spokesman, Michael Cianfrocca, said officials were not available for comment.

ISTOCK

LOTS IN CASH

The company will make sizable allocations of investor money to cash held at a Schwab-affiliated bank. That has drawn attention, as the company is earning a large portion of its revenue on the program from reinvesting those dollars. The allocations could be about 7% for an aggressive, 30-year-old investor and 15% for a more conservative 65-year-old, according to the disclosure.

Schwab's choices drew skepticism from some financial advisers.

"It seems Schwab is hard-selling having a cash position in the portfolio, which gives me pause, since it has become clear that will make up a not-insignificant portion of the expected revenue," said James D. Osborne, president of Bason Asset Management.

"Most investors have meaningful cash allocations outside their portfolios. I am not convinced, especially for more aggressive investors, that a cash allocation adds meaningful benefit to a diversified portfolio," he said.

Liz Miller, president of Summit Place Financial Advisors, called out some of the "fads" in Schwab's approach, including smart beta.

"Schwab's approach across asset classes embraces some of the latest research as well as some of the latest investment fads, such as smart beta, absolute-return goals and risk allocations," Ms. Miller said. "It may be a good marketing approach to include these, but if we embrace individual investors as long-term investors, these approaches may not prove more durable than or as successful as traditional approaches."

Schwab defends both approaches — its use of cash and smart beta — at length in the disclosures.

"The introduction of smart-beta strategies is one of the more exciting developments to hit institutional money management in recent years," Schwab wrote. "For some time, Schwab has been a thought leader in how investors can best use these strategies."

The service builds different portfolios for clients with different goals, but samples included exposures of up to 48% to five "fundamentally" weighted Schwab ETFs. These funds use corporate earnings reports, rather than a stock's market capitalization, to determine how much of a stock to include in an index.

> **"SCHWAB'S APPROACH ... embraces some of the latest research as well as ... fads."**
>
> **Liz Miller**
> President
> Summit Place Financial Advisors

The fundamental approach has been trademarked by Research Affiliates. And, in speeches and academic papers, Mr. Arnott has championed it as generating superior risk-adjusted returns.

The strategy is just one offshoot of smart beta. That concept is rooted in the work of academics, including Nobel laureate Eugene Fama, who attempted to identify phenomena in financial markets that provide superior returns for the same risk.

A growing number of proponents are fund companies marketing products for retail investors: Pacific Investment Management Co., another Research Affiliates client, as well as BlackRock Inc. and Dimensional Fund Advisors, which market their own variants.

"Ten years ago, there was a robust debate about whether this was a sensible strategy or not," said Chris Brightman, chief investment officer at Research Affiliates. "Today, it's less about whether it's sensible and more about the different firms' position to participate in the growing market segment."

Schwab has been an enthusiastic supporter, launching a lineup of fundamental funds.

The company says it uses cash in these portfolios for several reasons.

First, investors are risk-averse so they need exposure to defensive assets. Second, cash is less volatile and risky than other defensive assets, including short-dated bonds and gold. Third, cash has a low and stable correlation to other asset classes.

But in the robo-program, cash is also a major source of revenue for Schwab, along with payments by third-party fund managers and a practice known as payment for order flow, in which trades are routed to traders who compensate Schwab for the business. The company keeps the excess gains it earns reinvesting clients' cash allocations.

NO ADDITIONAL FEE

Schwab said the service will charge no fees on top of the 54 ETFs that currently meet its screening criteria. Investors will pay only the costs of the underlying products, all ETFs with annual expense ratios ranging from 0.04% to 0.48%.

Expense ratios are just one of the costs of investing in an ETF, but they are the easiest for an investor to control. Schwab said it tries to contain other costs by limiting its selection of ETFs to those with greater assets, under the assumption that those funds are less likely to close and make a distribution, which would be taxable.

Schwab also has avoided ETFs with high bid-ask spreads and tracking error, both of which measure costs that can erode investment returns.

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At long last, Japan appears to be turning around

'Abe-nomics' getting results, and China's rate cut doesn't hurt

By Jeff Benjamin

As an investment destination, Japan has had such a tarnished reputation for so many years that it might not be a place investors think about when considering international diversification. But the performance numbers are beginning to look pretty solid.

China's second interest rate cut in three months, announced Feb. 28, has increased attention on Asian financial markets while adding a reason to focus on the growth potential for Japanese equity markets.

"Something is happening in Japan, and things are starting to move," said Douglas Coté, chief investment strategist at Voya Financial Inc.

The 0.6% fourth-quarter economic growth that moved the country out of recession indicates the aggressive quantitative-easing program is working, according to Mr. Coté.

"We've seen lots of false starts from Japan, but there seems to be a vote of confidence that [Prime Minister Shinzo] Abe's economic policies are working," he said.

CONFIDENCE MEASURE

For U.S. investors, that vote of confidence can be measured in the performance of Japanese stock funds, as tracked by Morningstar Inc. The category average year-to-date (through Feb. 27) was a gain of 8.9%, versus a 6.5% gain by the MSCI EAFE Index. For the 12 months through Feb. 27, the category average return was 6.8%.

Among the top performers so far this year:

- Brown Advisory — WMC Japan Alpha Opportunities (BIAJX)
- Commonwealth Japan Fund (CNJFX)
- DFA Japanese Small Company I (DFJSX)
- Fidelity Advisor Japan B (FJPBX)
- Hennessy Japan Fund Investor (HJPNX)

The only single-country category with better performance is India funds, up 9.3% through Feb. 27.

After years of being out of favor, the $4.6 trillion Japanese economy is showing signs of an authentic turnaround. It's gaining investment converts along the way.

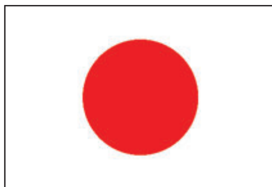
James Hunt, manager of the Tocqueville International Value Fund (TIVFX), has a 26% weighting in Japan, compared with a 19% benchmark weight.

"This is a multiyear phenomenon that is not anywhere near to being over," Mr. Hunt said.

The economic turnaround is all part of the experiment known as Abe-nomics, referring to the prime minister's multifaceted effort to devalue the currency and encourage corporate financial patriotism while employing an $85 billion-per-month stimulus program.

For context, the recently concluded quantitative-easing program in the U.S. peaked at $80 billion a month, and the U.S. economy is over four times as big as Japan's.

"You've got the government engineering a shift out of bonds and into equities through quantitative easing," Mr. Hunt said. "And it's becoming a patriotic duty among Japanese companies to do things like increase wages."



The duty relates to the one-year-old JPX-Nikkei 400 Index, which combines components of the country's two most popular stock indexes by including companies that adhere to investor-focused corporate standards, which Mr. Hunt said is attracting foreign investors.

They are still in draft form, but the corporate governance codes are affecting Japanese management, according to Drew Edwards, who manages more than $1.2 billion in global portfolio assets at Advisory Research.

'USING A CARROT'

Mr. Edwards has a 29.8% weighting in Japan in the Advisory Research International Small Cap Value Fund (ADVIX); his benchmark for that fund category, the MSCI ACWI ex-USA SMID Cap Index, is 25.3%.

"The JPX-Nikkei 400 is made up of the companies that best exemplify good governance, and it's using a carrot to do what most markets do with a stick," Mr. Edwards said. "This index is often referred to as the 'shame index.' If you're Toyota, and Nissan has already been added to the index, you will do whatever it takes to also become a part of the index."

A variety of criteria are taken into account in the process of inclusion, such as diversity of board representation, disclosure and accounting standards.

"They are all things that are very important and helpful to investors — particularly foreign investors," Mr. Edwards said.

"The real way they make money on the exchanges is by the volume, and a lot of those investors are foreign," he said. "Foreign investors wanted more corporate governance, which is what makes us excited. This is much more significant that the latest GDP numbers or a weaker yen."

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SEC limits who can qualify as a public arbitrator

Proposal excludes more who formerly worked in financial firms

By Mark Schoeff Jr.

The Securities and Exchange Commission has approved a Finra proposal that would put new restrictions on who can serve as public arbitrators.

Under the rule proposal, people who have worked in the financial industry at any point in their career would be classified as a nonpublic, or industry, arbitrator.

Under current rules, they could be reclassified as public arbitrators five years after leaving the industry.

In another big change, the rule would move to nonpublic from public arbitrator rolls those who have devoted 20% or more of their time to representing investors in securities claims over the previous five years.

It would allow them to re-enter the public roster after a five-year cooling-off period. But if they have been a plaintiff's attorney for more than 15 years, they are permanently disqualified as a public arbitrator.

Almost all customer claims against brokerage firms are settled in the Financial Industry Regulatory Authority Inc.'s arbitration system, which includes a total of 6,359 arbitrators, 3,518 of whom are classified as public.

Each arbitration case is heard by a panel of three arbitrators. The parties determine the makeup of the panel by striking arbitrator candidates until they get to three. Any party can select an all-public arbitration panel.

Critics of the current system say it favors Wall Street. The new rule targets that objection.

'PERCEIVED BIAS'

"The commission believes that the proposed rule change would help to address any perceived bias of public arbitrators by classifying certain individuals with either financial industry experience or significant experience representing investors as nonpublic arbitrators," the SEC said in its Feb. 26 regulatory order. "Accordingly, the commission also believes that the proposal would enhance the perception of neutrality of the entire Finra arbitration forum."

The new rule also would disqualify as a public arbitrator attorneys, accountants and other professionals who have worked for financial firms for more than 20 years.

If their career has spanned less than that amount of time, they can re-enter the public roster five years after ending their service for financial firms, up from the current two-year look-back.

First proposed by Finra last June, the measure received 330 comment letters. Finra is the industry-funded broker-dealer regulator.

One of the opponents of the change said too many arbitrators would be thrown into the nonpublic pool at a time when Finra has made all-public arbitration panels the default composition for case hearings.

"This classification change represents the latest in a series of rule changes aimed at raising the political correctness rating of the forum's roster at the cost of competence and adequacy of coverage," said Rick Ryder, editor in chief of the Securities Arbitration Commentator.

SHRINKING POOL

By Mr. Ryder's estimate, the number of public arbitrators would decline by 600 under the new rule.

He said only about 15% of seats in customer cases are available to nonpublic arbitrators, and warned that arbitration proceedings would be less efficient and effective.

"It dilutes the quality of the forum's performance," said Mr. Ryder, a former director of Finra arbitration.

It is confusing to put people who represent plaintiffs into the same arbitrator pool as those who have industry background, said Jason Doss, owner of an eponymous law firm and former president of the Public Investors Arbitration Bar Association.

"This will hurt investors," Mr. Doss said. "It will further reduce transparency about how Finra recruits and selects arbitrators to hear cases."

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INVESTMENT STRATEGIES

Keith Lanton

Zero-coupon bonds offer certainty

Holding tax-free municipals to maturity can make otherwise skittish investors more confident

The only certain thing about investing is uncertainty. That theme was validated last year and humbled the wise men of Wall Street. Seventy-two out of 72 economists polled predicted that interest rates would rise. Yet the 10-year Treasury yield fell to 2.20% from 3.00%. In addition, none of the economists foresaw the price of oil tumbling to under $60 a barrel from $110, yet it did.

Are there any instruments that can help investors deal with the endemic insecurity of the financial markets? Zero-coupon tax-free bonds can be both a timely investment and provide certainty in an uncertain world. They are one of a handful of investments that grow and provide a fixed payoff at a specific date. In essence, zero-coupon bonds force the investor to accumulate wealth.

Moreover, including high-quality zero-coupon bonds in a portfolio may give otherwise skittish investors the confidence and comfort they need to increase their equity allocation, as well as the fortitude to ride out — or invest more in — a turbulent stock market.

THE MAGIC OF COMPOUNDING

Albert Einstein said, "Compound interest is the eighth wonder of the world. He who understands it, earns it … He who doesn't ... pays it."

A bonus that zero-coupon bonds offer in an environment of low interest rates is the absence of risk when investors hold the bond to maturity.

Interest earned on zero-coupon bonds is reinvested in the bond, and the interest rate of the reinvestment is the yield to maturity. The compounding continues until maturity, when the bondholder receives the face value of the bond.

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Here is an example of the magic of compounding in today's municipal bond market:

Invest $55,000 in a AA-rated, tax-free zero-coupon bond insured by Berkshire Hathaway Assurance Corp. maturing in 18 years. At maturity, as long as the bond is solvent, the investor receives the face amount, or $100,000. The icing on the cake is that the investor owes no federal income tax on that growth. That represents a 3.70% federally tax-free yield to maturity. An investor in a high tax bracket would need to receive over 6% in a comparable taxable bond.

A TIMELY INVESTMENT

Zero-coupon tax-free bonds are also a timely investment. Intermediate and longer-term zero-coupon tax-free bonds are currently yielding about 20% more than comparable coupon-paying bonds.

Municipal bonds are the only segment of the bond market in the U.S. that is still dominated by retail investors. Low interest rates have disrupted the municipal bond market and divided bond investors into three distinct categories:

Yield hungry. Those who desperately seek high current income. They demand current coupons and in their quest for yield are reaching for longer-term and lower-credit-quality bonds.

Cautious. Those who remain committed to owning bonds but are very concerned about interest rates. They hide out in short-term bonds, waiting for rates to rise. They value portfolio diversification, crave the safety of bonds and want to earn a higher return than cash or the near-zero interest that money markets offer.

Throw in the towel. Those who think bond yields are too low and invest elsewhere. By and large, they have abandoned the bond market by liquidating their holdings and allocating that money instead to cash, dividend-paying stocks, real estate investment trusts and business development companies.

MUNI BONDS are the only segment of the market … still dominated by retail investors.

Intermediate to longer-term municipal zero-coupon bonds do not pay current income and do not offer short-term liquidity. Consequently, they are being neglected by yield-hungry and cautious investors because of their inability to satisfy their needs. A combination of stable supply and low demand for zero-coupon municipal bonds is causing the yield of such bonds to be higher than those of comparable, coupon-paying tax-free bonds.

Thus, for the right investor, zero-coupon tax-free bonds are a timely investment that provides certainty while forcing the investor to accumulate wealth through the magic of compound interest.

Keith Lanton is president of Lantern Investments, a New York-based wealth management firm.

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PRACTICE MANAGEMENT
Ray Sclafani

3 unique roles for advisers on a team

Well-defined job descriptions help a firm better serve clients and prepare for succession

There are countless benefits to building a team, yet according to our experience and research, few teams achieve the success they hope to. That can be attributed to a variety of factors.

Advisers create teams for several reasons, all of which require clearly defined roles and accountability within them.

Unfortunately, it doesn't always happen that way.

All too often I work with teams who have merged their practices but are still running two separate businesses, because they fail to leave their solo roles and step into new, team-based roles. That leaves members attempting to fill multiple rolls, which negates the benefit of forming a team in the first place.

THREE ROLES

The best teams have three adviser roles. Of course, several additional roles are filled by team members or consultants devoted to providing support in other areas. But these three roles are central to delivering on the promises you make to clients.

Senior lead adviser: Senior lead advisers should be focused on their activities as rainmakers. They should be consistently filling the pipeline, meeting with potential clients and centers of influence, and bringing them on board.

They should also be developing relationships with clients who will speak positively about the firm.

Their secondary role as a relationship manager is more strategic and assumed only when clients need a partner to help make a crucial decision.

For archived columns, go to InvestmentNews.com/practicemanagement

The senior lead adviser might be brought in when clients are especially important to your team's success or their situation necessitates a higher level of attention.

Senior lead advisers are sometimes the most technically proficient members of the team, and in many cases they have their certified financial planner or certified private wealth advisor designations.

The common trait of senior lead advisers is that they can make it rain.

Lead adviser: The primary function of the lead adviser is as a relationship manager concentrating on complete client care. That means being absolutely certain that no accounts are leaving the practice and that the team is delivering on promises made to clients.

A secondary set of responsibilities for the lead adviser encompasses four crucial responsibilities: uncovering new assets from existing clients; finding new revenue opportunities to serve existing clients more effectively; connecting with the heirs of clients' wealth, and knowing when and where that wealth is ready to transition; and engaging clients to uncover those who can advocate for the firm.

Those responsibilities require exhaustive industry knowledge and stellar communication skills.

Service adviser: Service advisers take care of all follow-through. They are essentially responsible for completing the work that ensures delivery of what the client was promised.

Front and center at some points and behind the scenes at others, service advisers make sure that all client information and paperwork is complete and in order.

Remember, however, that you want advisers in all capacities to be in front of clients as frequently as appropriate.

THE ADVANTAGE of having a team is that it allows members to home in with increased focus.

That kind of engagement makes clients feel served and supported. It also creates a familiarity between them and all advisers on your team.

That's important for a number of reasons, including that eventually service advisers will move into lead adviser and senior lead adviser roles, according to your succession plan needs.

The advantage of having a team is that it allows members to home in with increased focus and efficiency on their core competencies and the unique value they bring to the business.

This won't be possible if you or any of your team members are wearing "all the hats" or trying to fill the senior lead adviser and lead adviser roles simultaneously.

While you may work together to accomplish some of these duties, only one team member should be the driver of each.

Ray Sclafani is the founder and chief executive of ClientWise, a business and executive coaching firm working exclusively with financial professionals and teams.

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The Community Leadership Awards were established by the Invest in Others Charitable Foundation to recognize and celebrate financial advisers across the country for their exemplary leadership and contribution to philanthropic efforts.

Winners will receive a $20,000 donation to the charity they support.

Award categories include: Catalyst, Community Service, Volunteer of the Year, Global Community Impact and Lifetime Achievement.

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InvestmentNews

ON SOCIAL MEDIA
Kristin Andree

Apps to boost social media efforts

These mobile tools can help busy advisers who are on the go stay current with their clients

We have covered the basic apps that financial advisers should be using to ensure their social media efforts don't slow down when on the move (Hootsuite, Twitter, Facebook Pages Manager, LinkedIn and Bitly).

Now it's time to kick it up a notch. Here are a few more mobile apps to help make the most of your social media efforts and save some of your already-limited time.

LinkedIn Connected

While we would welcome the ability to meet personally with all our clients to congratulate them on that big promotion or wish them many happy returns, it isn't feasible.

Further, with millions of comments and posts crossing our LinkedIn news feeds daily, it's practically impossible to keep up with who has done what.

LinkedIn Connected provides you with timely, relevant reasons to reach out to your connections. It tells you who is having a birthday or celebrating a work anniversary, who has changed jobs or been promoted. (Just think: client engagement and rollover opportunities in one place.)

WHEN YOU can't meet in person, connecting with clients virtually, through apps such as Skype and FaceTime, is worth its weight in gold.

LinkedIn Connected also allows you to send a quick congratulatory note right from the app. This has proved an easy and efficient — yet genuine — way to reach out to clients, prospects and centers of influence.

You also can sync the app with your calendar. That allows you to receive push notifications before a meeting with a connection.

Evernote

Like many of my adviser clients, I seem to have my iPhone glued to me at all times. It tends to be the device on which I view most of the information and research I want to share with my clients.

When I'm on the move, I often come across an article headline that catches my eye or stumble on a good website that I simply don't have time to peruse. In those instances, Evernote functions as my virtual filing cabinet, storing pieces of content I want to refer to or follow up on later.

Dropbox

This cloud service allows you to save and store files, which can then be accessed from any device.

While Dropbox is excellent for all types of files, I have found a unique application for social media.

I created two files on the site — Photos/Stock Photos, and Quotes and Motivation — that I use a lot for social media posts.

It has been proved that posts containing a picture generate more views and engagement than posts without one.

With Dropbox, I can easily select a picture that's applicable to my post and attach it. I also frequently post quotes with either a branded company background or a picturesque background. Dropbox is an excellent place to store photos of your office or client events, allowing them to easily be uploaded to your social media sites.

"Happy birthday" images posted to a connection's wall or sent to them via text message also have prompted positive response. (Note: If you chose to use stock photos, check to ensure that they are royalty-free and are ones you're allowed to use).

Skype and FaceTime

Why run across town to wish people a happy birthday or offer congratulations when you can easily do it from your mobile device?

These tried-and-true apps provide excellent ways to get up-close and personal with clients. For your top clients and ones with whom you have a close relationship, they offer a face-to-face touch that is worth its weight in gold.

For archived columns, go to InvestmentNews.com/onsocialmedia

In addition, a number of our adviser clients are using Skype or GoToMeeting successfully to conduct sessions with clients (with the approval of their compliance department, of course). Something about clients' seeing the adviser's face when they speak works to strengthen and solidify the relationship.

Give these apps a try. Not only will you have grateful and increasingly engaged clients, but you may also save yourself some time in the process.

Kristin Andree is president of Andree Media & Consulting.

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Financial platform Wealth Access integrates with MoneyGuidePro

By Alessandra Malito

Wealth Access, a personal financial management platform, announced last Tuesday its integration with MoneyGuidePro, a popular financial planning software.

The companies combined the programs to make it easier for users to manage client finances and create financial plans in a streamlined process.

"We have found that many [advisers] were spending a lot of time gathering data to be able to have intelligent conversations with clients," said David Benskin, chief executive and founder of Wealth Access. "A lot of our clients are more financial planning-oriented, so it was a natural fit for us to integrate with MoneyGuidePro."

Wealth Access is an open architecture system, meaning it has the ability to function with other technologies. Previously, advisers had to sign into separate accounts and input data about clients' personal finances, such as held-away assets and liabilities.

That data, which are available on Wealth Access, now will be pushed through to MoneyGuidePro. From there, advisers can create a comprehensive financial plan.

Integration is a growing trend in the financial advice industry. During the Technology Tools for Today conference in Dallas last month, many companies announced such plans, including Riskalyze and CLS Investments. Financial advising software firm eMoney, recently acquired by Fidelity Investments, also announced plans to bring 28 companies onto its emX Select platform.

"Having that consistent experience for the adviser and client is important, and you're able to accomplish that through integration," Mr. Benskin said.

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High court will not hear case against BlackRock

Investors questioned securities-lending cut in iShares ETFs

By Trevor Hunnicutt

The U.S. Supreme Court has declined to consider a lawsuit against BlackRock Inc. brought by investors who said the company keeps too much of what it makes from lending securities held by its iShares ETFs.

The court's decision last Monday, which came with no explanation, appears to end a conflict between the world's largest fund manager and a group of pension funds. Their claims were originally dismissed by a federal judge in 2013, and again by an appellate court last September.

Securities lending can be a lucrative activity for fund managers. They sell their securities to investors — such as hedge funds — who may want to short a stock, for instance. Fund managers often use the proceeds of securities lending to boost returns.

The pension funds said a BlackRock subsidiary charged iShares fund investors a fee "disproportionately" higher than the industry norm for acting as a middleman between the funds and the institutions borrowing the securities. Those fees come at the expense of investor returns, they argued.

The United States Court of Appeals for the Sixth Circuit said the case shouldn't move forward because the Securities and Exchange Commission approved the securities-lending program and because there was no legal basis for challenging the fees.

But the pension funds said other appellate courts had found investors in other cases could bring similar lawsuits.

BlackRock officials declined to comment. The company has said in the past that the case lacks merit.

BLOOMBERG

ENDS THE BATTLE

C. Mark Pickrell, a lawyer with the Pickrell Law Group who represented the pension funds, called the decision disappointing and said it effectively ends his clients' case.

"Apparently this is a problem Congress needs to fix," Mr. Pickrell said.

Even without this case (Laborers' Local 265 Pension v. iShares Trust) on the docket, the nine-member court faces key decisions concerning fund fees.

On Feb. 24, it heard arguments in Tibble v. Edison International. That case centers on the question of whether an employer violated its fiduciary duty when choosing retail funds over cheaper institutional share classes. A ruling is expected later this year.

The Obama administration also has emphasized the fees charged on investments of those saving for retirement.

The Supreme Court's decision not to hear the BlackRock case was first reported last Monday by Law360.

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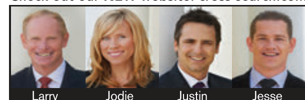

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ISTOCK

Owning rentals requires tax planning, strong stomach

By Darla Mercado

The rent is too darn high.

That's great news for clients looking to earn rental income from a second home they own — as long as they're willing to put in the required elbow grease to maintain the property and to deal with the extra tax planning.

Research from housing marketplace Zillow showed that rents leaped at the start of the year. The median rent in the U.S. hit $1,350 in January, reflecting a 3.3% increase year over year. The highest rents were in California, with San Jose's median rent at $3,190 and San Francisco's at $3,055 — both reflecting double-digit increases from the year-earlier period.

Demand for rentals is rising as people are finding it difficult to scrape together the dollars needed for a home purchase.

3.3% Increase in median rent for the U.S. over the past year

Considering the rising rents and the fact that fixed-income investments are still getting pulverized by low interest rates, clients with a second home might be tempted to rent it to supplement their income.

"If you can keep the home and manage it yourself, you'll get more income than you would from an alternative investment with the same amount of money," said Philip G. Lubinski, founding partner with First Financial Strategies.

FIT TO BE A LANDLORD?

"But for someone who hasn't had rental property for most of their life and now they think this is a good idea, it may be disastrous," Mr. Lubinski said. "They don't know how to be an effective landlord and how to do all the work that's involved in generating rental income."

Before delving into the potential tax and income benefits of a rental property, clients need to determine whether they're cut out to screen tenants, make repairs and handle the dirty work of managing renters.

Clients who are approaching retirement and still have the energy to manage a property tend to fare well, but the maintenance often becomes burdensome as those clients age, Mr. Lubinski said.

And there's always the risk of getting a nightmare tenant.

For example, Mr. Lubinski had a client who owned a rental duplex in Denver and decided to sell it. The tenants moved, but — unbeknownst to the client — they had been cooking methamphetamine there. An inspection at the request of a potential buyer revealed structural damage (caused by the drug lab) that required $40,000 worth of repairs.

"You don't know the damage that a tenant will do," Mr. Lubinski said.

In another case, George Papadopoulos, a fee-only adviser in Novi, Mich., had a client who was renting out a cottage in the Wolverine State and had incurred a stream of losses.

The client couldn't deduct the losses on the rental property until he sold it, which he did in 2014.

"We had a nice, large loss that we were able to deduct in 2014, which brought his taxable income way down," Mr. Papadopoulos said. "To plan around that — since we knew the losses were coming — we accelerated a bit of the client's income [which is commission-based] from his employer."

Being a landlord isn't for the faint of heart or for those looking to make a quick and easy buck, said Mr. Papadopoulos, who is a landlord himself.

"I'm not a guy who fixes things, and if something breaks in my house, I find someone else to fix it," he said. "I still see people who are interested in buying homes and renting them out, and that's their retirement fund. I just shake my head."

TAX PLANNING

Let's say clients are ready to roll up their sleeves and rent out a second home they already own, perhaps a beach house. The property will generate income that will require special tax planning.

The first thing to consider is the Internal Revenue Services' 14-day test to determine whether the owner is using the rental unit as a home.

A property is considered a home if clients use it for personal purposes for more than the greater of 14 days or 10% of the total days it's rented to others at a fair price.

If the second house is primarily used as a residence and rented out for fewer than 15 days of the year, then its primary function is not as a rental property. Therefore, clients don't have to report rental income and expenses.

On the other hand, if clients don't use the beach house, all property-related expenses are deductible, and all rental income is taxable, according to Tim Steffen, director of financial planning at Robert W. Baird & Co. Advisers will attach the rental income or loss to a client's 1040 using Schedule E.

Finally, if clients use the beach house as a home but rent it out more than 15 days of the year, they need to report the rental income. They also must divide the expenses related to rental use and personal use: Rental expenses are deductible, personal expenses aren't.

"Anything in the rental [expense] category can be used to offset the rental income that's received," Mr. Steffen said. "From a record-keeping point of view, the big thing is to track rental and personal use days, and all the expenses."

WATCH OUT FOR THE NIIT

Rental income is considered passive, so it could be subject to the 3.8% net investment income tax if your client's modified adjusted gross income is over $200,000 for single filers or $250,000 for married couples filing jointly.

Taxpayers can also deduct passive-activity losses from other passive income, but they should be aware that those deductions begin to phase out if the taxpayer surpasses the MAGI threshold of $100,000.

"It's probably too late for 2014, but for 2015, if you're bumping against that $100,000 threshold and you have a loss in rental property, be careful about doing Roth conversions or recognizing large gains that will push you over the threshold for the deduction," Mr. Steffen said.

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Social Security's negative returns

Continued from Page 3
include the impact of additional payroll taxes used to fund Medicare.

While a very low earner who was born in 1949 and retired in 2014 at age 65 is expected to receive $28,336 more in lifetime benefits than the cumulative value of taxes paid on his earnings, a high-earning man is expected to be a net loser to the tune of nearly $196,500, according to Mr. Schieber's calculations.

For a single man of the same age who was a medium earner over his career — defined as average annual earnings of $40,784 — the net loss of $85,110 from participating in Social Security would be the equivalent of 2.1 years of his average indexed lifetime earnings used to determine his benefits.

The only people in the medium-earner category to come out ahead are a single-earner couple. They can expect lifetime benefits in excess of the value of taxes equal to $151,131, or 3.7 years of average earnings due to the value of spousal and survivor benefits for the nonworking spouse.

For maximum earners — defined as $98,750 in average annual earnings — the net lifetime loss is $378,171 for a single man, $340,354 for the longer-lived single woman and a whopping $665,582 for a married couple with both spouses as maximum earners. Only the single-earner married couple breaks even in this category.

'DEADWEIGHT LOSS'

"One way folks with a reasonable life expectancy can ameliorate the deadweight loss is to pursue claiming strategies that will maximize their expected lifetime benefits," Mr. Schieber told me in an email.

Although the percentage of Americans claiming Social Security at 62 has declined considerably in recent years — to 32% from 43% for men and to 38% from 49% for women — 62 remains the age most begin to claim Social Security benefits.

$196.5K
Approximate amount of the tax-benefit differential for a high-earning man

For 62-year-olds who claim in 2015, the monthly benefits will be 25% lower than if they had waited until their full retirement age of 66. The reduction will grow to 30% as the full retirement age rises to 67 by 2022.

A separate article in the Journal of Retirement, "Why retirees claim Social Security at 62 and how it affects their retirement income," found that those who delay claiming until their full retirement age tend to have greater income and wealth in retirement and rely less on Social Security than those who claim earlier.

"Even when comparing early and delayed claimers with similar total income after claiming, average household income for delayed claimers was higher at 72 than for early claimers," wrote Mark Glickman and Sharon Hermes, senior economists with the U.S. Government Accountability Office.

"Increasing life expectancy and time spent in retirement raise the potential costs to retirees claiming early," they wrote.

While some advisers may focus on delaying Social Security until 70, the real challenge is to nudge clients to delay claiming until 66.

That way, more retirees would benefit from larger monthly income and no restrictions on their earnings while receiving benefits and possibly using creative claiming strategies.

(Questions about Social Security? Find the answers in my new ebook, available at InvestmentNews.com/MBFebook.)

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Nuveen's ETF plan

Continued from Page 3
and there are some large active asset management firms doing this. The momentum is there, compared to where it was over 10 years ago."

TIAA-CREF completed its acquisition of Chicago-based Nuveen in October, merging two companies with distinct cultures but a common goal to increase sales among advisers. ETFs may be a key component of that effort, as they have become a popular investment option deployed in fee-based accounts, partly because of their perceived cost advantages.

APPROVAL PROCESS

If the regulatory route for Nuveen follows that of previous applicants, it could take at least several months to get approval. And though the company is under no obligation to create the funds if given the go-ahead, a green light would give it an advantage over competitors that haven't gone through the process.

There were 14 applications for new brands in the category last year, according to a database maintained by ETF.com, including Wells Fargo & Co.; Janus Capital Group Inc.; Goldman Sachs & Co.; and the owner of American Funds, Capital Group Cos. Inc.

Goldman Sachs won approval for active funds and funds tracking indexes developed by the company. American Funds also won approval for active ETFs. The Securities and Exchange Commission has not issued a public response on the applications by Janus or Wells Fargo.

No ETF issuer has been granted permission to build actively managed ETFs that do not disclose underlying holdings regularly. But Eaton Vance Corp. recently got the OK for a mutual fund-ETF hybrid called NextShares that would have that ability.

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GETTY IMAGES

Merrill to advisers: Get water

Continued from Page 3
tation. "It is an investable theme, but it's not just about buying the underlying commodity — water — it's about buying companies that clean the water, that build the infrastructure," Ms. Bartels added.

Broadly speaking, commodities have been disappointing. Mutual funds holding a basket of commodities bled 21% over the year ended Feb. 28, while precious metals funds slipped 12% in the same period, according to Lipper. Those categories also posted dismal returns over three and five years.

But its emphasis on water, which Merrill first presented as a long-term investing idea in 2013, isn't primarily about returns. The theme also can be used to bring client portfolios in line with values of environmental sustainability or social equity.

Advisers can't invest in water directly. Investing in water usually means allocating to companies that pump, pipe and filter it. But investors have options — from hedge funds and ETFs to unit investment trusts with baskets of water-related stocks, such as the ones that Merrill offers.

Among the ETF options are the PowerShares Water Resources (PHO), Guggenheim S&P Global Water (CGW) and the PowerShares Global Water (PIO).

REGULATORY ADVANTAGES

Some companies enjoy regulatory advantages that let them control their markets and pass price increases to customers. And they may be able to exploit growth in emerging markets and water scarcity in the western U.S.

"For China to grow its economy, they have to produce more clean water," said David Richardson, head of U.S. business development for Impax Asset Management, which runs a $1.8 billion private water strategy and the Pax World Global Environmental Markets Fund (PXEAX). "It's cold, red-blooded capitalism."

That said, investors may have to wait for those long-term benefits.

PHO, CGW and PIO trailed the MSCI World Index's 5% return last year; just one, CGW, exceeded the index's 11.4% return over five years.

While some advisers are more interested in impact investing than others — Merrill didn't provide hard numbers on how popular its strategies have been with financial advisers — large brokerages such as Merrill Lynch are putting increasing force behind their push to expand their impact investing product suites.

"The majority of our financial advisers are very familiar with impact investing," Ms. Bartels said. "The challenge becomes: Is your client interested?"

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Moore latest to exit LPL

Continued from Page 2
with Mr. Moore just five days before, but the announcement came as a shock.

"It's not a devastating blow, but it's a disappointment," said Mr. Armstrong, president of Monument, a $200 million RIA that brokers through LPL. "Advisers are sad to see such a good, smart person who had genuine interest in our businesses ... leave LPL," he added.

Mr. Moore, 52, whose resignation becomes official Friday, had been with LPL since 2008 and president since 2012. He is joining institutional money manager Legal & General Investment Management America as CEO.

The move leaves Mr. Moore's successor, Dan Arnold, with big shoes to fill. Mr. Arnold, 50, joined LPL in 2007, after it acquired Uvest Financial Services Group Inc., where he had been president and chief operating officer. He has served as LPL's chief financial officer since June 2012.

"It's a compliment to the firm when other companies want your executives," said Garrett Andrew Ahrens, CEO of Ahrens Investment Partners. "It's just unfortunate that a lot of good talent has left in the past year."

> "I'M SURE IF Mark [Casady] hand-selected him ... then he's a great candidate."
>
> **David Armstrong**
> President
> Monument Investment Partners

Mr. Armstrong and Mr. Furey voiced confidence in the new team and the strength of many key executives who remain at LPL.

"I don't know him," Mr. Armstrong said when asked about Mr. Arnold. "I'm sure if Mark [Casady] hand-selected him to replace Robert, then he's a great candidate."

DEAN STEVENSON

Dan Arnold: LPL's new president previously served as its finance chief.

William Katz, an analyst with Citigroup Global Markets Inc., said the executive changes could ultimately bolster LPL's growth.

"We do see the change as a natural progression, given the respective backgrounds and experiences," Mr. Katz said. "We understand the move was voluntary by Mr. Moore and not a reflection of accounting issues or strategic differences."

In October, LPL Financial Holdings Inc., parent of the IBD, said it expected to incur up to $23 million in charges — $18 million more than previously anticipated — to resolve yet-to-be-disclosed regulatory matters such as fines and restitutions.

"To be fair, LPL's financial execution has been mixed under both Mr. Moore and Mr. Arnold," Mr. Katz said.

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Devil in details of Rubio proposal

Continued from Page 1
Although advisers embrace the idea of whittling down the country's massive tax laws, when they take a closer look at the Rubio-Lee plan, they have concerns.

Juan Ros, lead adviser at Lamia Financial Group, said reducing the number of tax brackets from the current seven to the two Mr. Rubio and Mr. Lee propose means that the 35% rate begins way too early on the salary scale at $75,000.

"That seems pretty high," Mr. Ros said. "It's just a few percentage points lower than [the current highest rate] now at 39.6%."

The senators presented their plan as a white paper and hope to turn it into legislation as Congress begins to debate comprehensive tax reform.

"The vast and overwhelming majority of Americans will see significant tax relief here," Mr. Rubio, who is mulling a presidential campaign, said at a Capitol Hill press conference last Wednesday. "Our hope here is to trigger economic growth. We believe economic growth will help all Americans to improve how much money they make by creating better-paying jobs."

Mr. Ros endorsed the senators' effort but cautioned that more work needs to be done to flesh out the proposal.

"At least there's some proposal on the table as opposed to nothing," Mr. Ros said. "There's more positive than negative, so I would give it a 'B.' There's room for improvement."

The plan has to be analyzed for its total impact on the economy in order to reach a conclusion about its efficacy, Mr. Sarenski said. For instance, what effect would eliminating deductions for state and local taxes have on the nation's demographics?

> "A PLAN THAT is not revenue neutral would be destabilizing."
>
> **Chris Chen**
> Wealth strategist
> Insight Financial Strategists

DO PEOPLE MOVE?

"How does that affect high-tax states like New York, where you have high income and property taxes?" said Mr. Sarenski, also a CPA. "Do people move? Do businesses move?"

Advisers balked at the senators' advocacy for eliminating almost all favorable tax treatment.

Sen. Lee acknowledged that he'll have to take on skeptics who want to save cherished tax breaks.

"We're trying to narrow it down to what most Americans rely most on in the code," he said at the Capitol Hill press conference. "In order to achieve the level of simplicity that we need, we concluded it was appropriate to narrow it all down to these two deductions [mortgage and charitable]. If you ask most Americans, hard-working Americans would tell you they would like more simplicity, and that's what we're trying to achieve."

An element of the Rubio-Lee plan that is likely to sit better with advisers would ensure that businesses organized as C or S corporations, or pass-throughs, pay the same tax rate.

Skeptics of corporate-only tax reform argue that lowering the corporate tax rate without addressing businesses that operate off of their owner's tax return would give an unfair advantage to the traditional business model.

Many financial advisers operate their practices as pass-throughs.

"We want them to have parity in the tax code with big businesses because that's where a significant amount of our business activity is occurring in America today," Mr. Rubio said.

The senators downplayed questions about how to pay for the tax reductions. They said the plan must be viewed within the context of generating economic growth and being paired with a similar effort to cut spending and reduce the deficit.

It's a mistake not to pay for the tax cuts, said Chris Chen, a wealth strategist at Insight Financial Strategists.

"A plan that is not revenue neutral would be destabilizing for the economy and for all of our financial futures," Mr. Chen said.

> "THE VAST ... majority of Americans will see significant tax relief."
>
> **Sen. Marco Rubio**

BLOOMBERG

Mr. Rubio said more work will be done on the plan.

"This is not a take-it-or-leave-it offer," he said. "But I think it is a massive first step toward what I hope will be the kind of pro-growth, pro-family tax reform that our nation needs."

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Pay models evolving

Continued from Page 1
debt and tax planning.

He now charges a flat fee of $4,800 a year.

"A flat fee is fair to the clients and compensates me adequately for my work," Mr. Litovsky said.

While 95% of investment advisers set fees based on AUM, according to the 2014 *InvestmentNews* Financial Performance Study of Advisory Firms, several other compensation methods are gaining traction. These models are especially popular with new and young advisers who don't want to join most of the industry in targeting wealthy individuals and families.

ANNUAL RETAINERS

Advisers who charge an annual retainer that covers asset management and financial planning services — including tax, college and retirement — say the approach reduces the possibility of conflicts of interest.

Jacob Kuebler, an adviser and partner with Bluestem Financial Advisors, said advisers who charge clients based on AUM can be conflicted when decisions that would be in clients' best interest would also reduce their portfolio assets — and therefore the adviser's income.

Mr. Kuebler wondered if advisers charging 1% on AUM would be willing to recommend that clients sell securities to pay off their mortgage. What if clients have farmland? Would the adviser be tempted to recommend its sale to turn it into financial assets that could become part of a portfolio and generate fee income?

The retainer model is becoming increasingly popular with advisers who serve clients in the wealth-accumulation phase of life. It lets them base their fees not just on the assets they manage for a client, but on the client's total financial picture, according to Mr. Kuebler. It also generates stable revenue that won't decline if clients' investment value drops amid difficult markets.

In addition to the annual fee, which most expect clients to pay upfront or quarterly, they can charge for services with extra complexity.

The model's biggest downside is that it can be difficult to explain to clients how the fee is calculated, and, as a result, hard for clients to compare prices, Mr. Kuebler said.

Clients also have to pay the retainer out of cash flow instead of having it deducted from an investment account, as happens when the fee is based on a percentage of assets, Mr. Kuebler added.

"We don't see that as a bad thing, but it means you have to show your value more regularly," he said.

His clients pay annual retainers based on their assets and income. For instance, a couple in their 30s with a household income of about $250,000 and assets of between $500,000 and $1 million will pay $4,000 to $6,000 a year. Retirees who may have a net worth of $3 million to $5 million will pay between $10,000 and $20,000 a year, Mr. Kuebler said.

> "IT'S EASIER to explain to clients when it works just like their cellphone bill."
>
> **Mary Beth Storjohann**
> Chief executive
> Workable Wealth

Another approach, the subscription model, is similar to the annual retainer system.

Mary Beth Storjohann, chief executive of Workable Wealth, said it is especially suited to advisers working with younger clients, specifically those from Generations X and Y, who are used to paying monthly bills.

Ms. Storjohann charges an upfront fee of $999 to $1,249 that covers the cost of completing a financial plan. Clients also pay a monthly fee of $149. She has raised that amount incrementally over the past two years and hopes to get it to about $200. It covers advice provided over the course of the year, and she commits to communicating with them via email or phone calls each month.

"It's easy to explain to clients when it works just like their cellphone bill," Ms. Storjohann said. "It makes the sale easier."

MONTHLY PAYMENTS

The monthly payment system is easier on clients' cash flow and produces a monthly paycheck for the adviser.

The biggest concern with the model is its sustainability. How many clients can advisers accept when they agree to monthly check-ins?

Another way subscriptions can backfire: Clients can go online and cancel services at any time, without even talking with the adviser, according to Ms. Storjohann.

"It's easier for them to leave," she said.

Charging by the hour is gaining supporters, too.

Sheryl Garrett, who started a network of hourly based, fee-only financial advisers in 2000, said it is the best way to serve middle-income households.

"Focusing on middle-income clientele is where my heart and passion always have been," said Ms. Garrett, whom President Barack Obama has recognized as an adviser who puts clients first.

Such an approach can work especially well with these clients, who typically don't have many complicated planning needs.

The Garrett Planning Network now has about 320 members.

Supporters say the approach is understandable to clients and lets advisers be paid while they get to know a client — avoiding becoming involved with someone who may not be a good fit for them.

Tracking hours spent with clients, and billing and collecting for those hours, is a challenging aspect of this method.

Advisers using it generally charge between $180 and $300 an hour, with the average being just under $200 an hour, according to the network.

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ADVISER COMPENSATION CLASH

NAPFA critic tossed

Continued from Page 1
stance of the letter was not a factor" in the resignation request.

Mr. Whitehead, who has a long history of pushing for higher fiduciary standards for advisers, said being asked to resign "wasn't a crushing blow," but he stands by his position that setting fee structures based on a client's asset allocation is a blatant conflict of interest.

"If you've got a horse in the race, you can't tell people how to bet," he said. "I think the content of what I wrote sort of galled them. I think they think I leaked it to the media before the committee meeting, even though I sent it to the committee a couple days before I shared it with anyone else."

Mr. Whitehead's memo was the result of a committee assignment to analyze certain aspects of NAPFA's compensation rules and guidelines. According to Mr. Brown, the analysis should not have been made public.

Compensation committee chairman Bill Prewitt, founder of Charleston Financial Advisors, said neither the fiduciary nor compensation rules at NAPFA have been changed as a result of the memo. But, he added, "insights are always taken into account."

FIDUCIARY STANDARDS

Mr. Brown went a step further, saying that some of Mr. Whitehead's proposals related to tighter fiduciary standards "will probably be incorporated in some way, shape or form in the ultimate report," which he described as a body of guidance for the membership.

The central issue of the now-infamous memo was based on cutting assets under management fees for low-yielding allocations. Mr. Whitehead said the practice has been increasing since the financial crisis, with yields on cash-related investments being pushed to historic lows.

While some advisers justify the practice as being the right thing for clients, others see it as a potential temptation to move money into riskier assets in order to earn a higher fee.

CONFLICTS OF INTEREST

From Mr. Whitehead's perspective, cutting fees for cash allocations is just the most recent example of where conflicts of interests can crop up.

Bert Whitehead: "I think ... what I wrote sort of galled them."

"This is all the kind of stuff [President] Obama is talking about in terms of conflicts of interest among financial advisers," he said.

Mr. Whitehead's public and aggressive push for higher fiduciary standards is not new.

In a 2011 opinion piece, he cited half a dozen examples showing how fee-based advisers can easily get tripped up by conflicts of interest.

"Getting people to move their 401(k) assets so you can manage it and charge an advisory fee is a perfect example," Mr. Whitehead said last Thursday. "It's a huge advantage for advisers to talk you into it because the adviser benefits a lot."

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Some see bubble in RIA valuations

Continued from Page 4
HighTower Advisors said last year that it would slow additions to its original partnership channel, in which advisers receive equity in HighTower and become W-2 employees. Instead, it said it would concentrate on building out its network channel, with advisers paying for access to the HighTower platform but still running their own firm.

JONATHAN L. SMITH

> "WHEN THE PRICE disconnects a little ... it gets everyone's attention."
>
> **Elliot Weissbluth**
> Chief executive
> HighTower Advisors

HighTower chief executive Elliot Weissbluth said banks and private equity investors have helped make valuations top-heavy.

"If you're purely a financial seller and you're selling to a purely financial buyer, then I would agree that the pricing and structure have gotten a little ahead of [themselves]," Mr. Weissbluth said. "When a bank comes in and decides they want something, and the price disconnects a little from the marketplace, it gets everyone's attention."

Even some private equity firms are taking a break from investing in RIA acquirers, partly because of concerns about being able to recoup the cost of capital, according to Mr. Brinker.

"You haven't seen private equity fund a new venture," he said. "I think the jury is still out on whether [roll-ups] can create shareholder value."

But while private equity and some consolidators have slackened their pace, other factors could push prices higher near term.

Banks, which make cyclical moves in buying investment advisers, are showing a renewed interest and may be willing to bid up prices, according to Mr. Brinker.

For example, Live Oak Bank, a small-business lender that funds adviser acquisitions, announced in July that it had made $100 million in loans to investment advisers in the year since it began offering them.

> **$550M**
> Focus Financial's recent addition to its war chest

Jason Carroll, managing director of investment advisory at Live Oak Bank, said that he doesn't see the number of acquisitions slowing but that it has been a sellers' market.

PAYING A PREMIUM

"There are so many buyers versus sellers that people are willing to pay a premium for the book," Mr. Carroll said.

There's also a larger number of what Mr. Brinker called "regional" RIAs with about $1 billion in assets that can self-fund an acquisition.

Daniel Seivert, who helps value firms through his company, Echelon Partners, argued that valuations aren't high and that consolidators aren't retreating because of capital.

"They're just having a hard time finding people who will take their deal terms and work for their organizations," Mr. Seivert said in an email. "Valuations are not at a high point."

Other consolidators remain in the hunt.

Focus Financial Partners, which built its business model on taking equity stakes in RIAs in exchange for capital, is set to close one of its strongest quarters ever in terms of purchases, according to co-founder Rudy Adolf. Focus has picked up about 33 partner firms since it was founded in 2006.

The acquisition-hungry should be ready to open their wallets wide, however. To fuel its investments, Focus recently added to its war chest about $550 million in credit from major banks, including SunTrust Banks Inc. and Bank of America Corp.

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My Independence Day

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