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January 1, 1875

First private pension plan established in the U.S.

August 14, 1935

Original Social Security Act signed into law.

January 31, 1940

Ida May Fuller receives the first monthly benefit from Social Security. Her check is for $22.54.

July 30, 1965

Lyndon B. Johnson signs Medicare and Medicaid into law.

September 2, 1974

The Employee Retirement Income Security Act of 1974 is enacted, creating a regulatory framework for retirement plan fiduciaries.

November 6, 1978

Revenue Act of 1978 fo
establishes the 401k pla

Nove

First

May 4-5, 2015

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March 23, 2010
Barack Obama signs the Affordable Care Act into law.

March 26, 2007
InvestmentNews hosts inaugural Retirement Income Summit.

rmally
n.

January 2, 2013
Barack Obama signs into law the American Taxpayer Relief Act of 2012, raising federal estate taxes to 40% and the top marginal income tax rate to 39.6%.

December 8, 2003
George W. Bush signs the Medicare Prescription Drug, Improvement and Modernization Act of 2003, creating health savings accounts.

ember 7, 1993
target-date fund is launched.

August 14, 2010
Social Security turns 75. The average monthly benefit is just over $1,050.

JON KRAUSE

Spotlight

Retirement Plan Advisers

401(k) bond fund lineups are getting a makeover. Plus, why tax diversification is important and what industry leaders see on the horizon. **Pages 12-16**

March 23-27, 2015

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Clock now ticking on SEC's fiduciary standard

By Mark Schoeff Jr.

Two years into her term, the financial advice industry's chief regulator finally showed her hand last week in support of a uniform fiduciary standard. Now the clock starts ticking on making it a reality.

Mary Jo White, chairwoman of the Securities and Exchange Commission, stepped into an already fierce debate between Wall Street and the White House over a related rule the Labor Department is considering for advice on retirement accounts.

Ms. White's long-awaited stance on a fiduciary duty for all retail investment advice was fundamental to starting the discussion at a currently split commission. But there's a long road ahead, and it's uncertain whether Ms. White's tenure will last the journey.

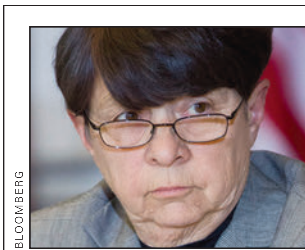
"Even if they were ready to pull the switch today — and they're nowhere near that — as a technical matter, it takes a substantial period of time," said Robert Kurucza, a partner at Goodwin Procter and a former associate director of the SEC's Division of Investment Management. "It doesn't happen overnight."

Even in the most favorable environment, the rulemaking process can take more than a year. The challenges facing Ms. White range from the timeline to produce a rule — the new president who will be elected in 15 months may want to appoint his or her own SEC chief — to the competing interests that will parse every nuance of a proposed rule and push back hard if some detail is not to their liking.

Ms. White was clear about her position in remarks to a Securities Industry and Financial Markets Association meeting in Phoenix last Tuesday. She said the SEC should "implement a uniform fiduciary duty for broker-dealers and investment advisers where the standard is to act in the best interest of the investor."

The financial industry has been watching closely for Ms. White's position, which breaks a standoff between the two Democratic commissioners (who support a rule) and two Republican commissioners (who oppose it) on the five-person panel. Ms. White said she will begin talking with the other commissioners about the

Continued on Page 32



BLOOMBERG

Outside examiners: The SEC chairwoman endorses third-party exams for RIAs. **Page 2**

Editorial: Getting behind a uniform fiduciary standard is the easy part. Writing one that is both effective and practical is the hard part. **Page 6**

F-Squared still struggling in wake of SEC charges

Asset management firm laid off 25% of its staff last week

By Trevor Hunnicutt

IN 2013, F-Squared Investments Inc. was on a hot streak. The asset management firm had won responsibility for more than $20 billion of investor money, most of it over the prior five years. The firm's killer app was an algorithm developed by a then-college student that told investment managers when to buy or sell a small set of ETFs.

But a routine examination by the Securities and Exchange Commission that year would lead to charges in 2014 that turned the company upside down and from which it is still reeling. Just last week, it laid off 40 workers — 25% of its staff — as it continues to try to stanch the flow of assets out of the company and fights for its reputation.

What the SEC discovered was that F-Squared misled investors by claiming its performance history was based on an actual trading record that went back to 2001, when in fact, it only had back-tested its vaunted algorithm. Last December, it agreed to pay $35 million to settle the SEC charges.

While the company has been trying to move on, its former chief executive, Howard B. Present, has not. He left F-Squared a month before it settled with the SEC and is fighting civil charges brought against him by the regulator. The two sides are expected to square off in Boston federal court proceedings as early as this month.

The lawsuit against Mr. Present will put a fresh spotlight on the investing industry's safeguards against fraud. As advisers and platform minders

Continued on Page 32

Howard B. Present: F-Squared's former CEO is fighting civil charges brought against him by the SEC.

BLOOMBERG

Inside

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A win and a loss

Ex-NFL lineman Bruce Wilkerson was granted a $2 million arbitration award, but he has virtually no chance of getting paid.

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Court victory

A former Raymond James broker had a $650,000 discrimination award reinstated by a federal appeals panel.

Page 4

Finra face-lift

The regulator has made it easier to find key information on BrokerCheck, its online database for broker background information.

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EDITOR'S NOTE

SEC moves closer to fiduciary standard

Without a doubt, the big news of last week was the fact that Mary Jo White finally let us all in on her personal position concerning fiduciary standards.

Ms. White, who has served as chairwoman of the Securities and Exchange Commission for nearly two years, came out in favor of a uniform fiduciary standard for broker-dealers and investment advisers. In other words, she supports the notion that brokers who hold themselves out as financial advisers to clients who don't know the difference between a salesperson and an adviser should be held to the same standard of fiduciary care as a true financial adviser.

Frederick P. Gabriel Jr.

Admittedly, my first reaction was "Really? Way to go out on the limb there, Mary."

To my way of thinking, a universal fiduciary standard is pretty much a no-brainer. It's the only way to ensure investors get solid advice and aren't pointed in the direction of products with exorbitant fees that diminish returns.

Obviously, the two Republican SEC commissioners who opposed it disagree.

InvestmentNews has been reporting on this topic since 1999, when the SEC passed a rule exempting fee-based brokerage accounts from the fiduciary requirements of the Investment Advisers Act of 1940.

Though the rule was not formally adopted, it resulted in a lawsuit by the Financial Planning Association and ignited a long, and often contentious, debate about fiduciary duty.

ERADICATING FAR-REACHING CONFUSION

Though we have covered both sides of the debate, *InvestmentNews'* editorial board has long taken the position that a uniform fiduciary standard of care is best for investors.

Our position is that a single standard would eradicate far-reaching confusion among investors about advisers' titles, obligations and legal responsibilities to their clients. We reiterate that position in this week's editorial on Page 6.

I'm happy to see the industry slowly working its way toward adopting a fiduciary standard. To think that last July, *InvestmentNews* ran an in-depth cover story that characterized the outlook for a uniform standard as bleak.

Fortunately, that outlook has brightened — thanks mainly to the Department of Labor's efforts to require brokers who advise clients on their retirement accounts to adhere to a fiduciary standard.

It has also brightened because a lot of people put their heart and soul into making a fiduciary standard a reality.

There are too many of these folks to call out individually, but one who deserves mention is Skip Schweiss, managing director of adviser advocacy at TD Ameritrade Institutional. Last week, Skip was named Fiduciary of the Year by The Committee for the Fiduciary Standard, a group of investment professionals and fiduciary experts who think all investment and financial advice should be rendered by those who adhere to a fiduciary standard.

fgabriel@investmentnews.com, Twitter: @fredpgabriel

Third-party exams get a push

SEC's endorsement of uniform fiduciary rule lends momentum to outside testers

By Mark Schoeff Jr.

When Securities and Exchange Commission Chairwoman Mary Jo White endorsed a rule to raise investment advice standards for brokers, she also jump-started a controversial idea to expand the agency's coverage of investment advisers: farming out exams to the private sector.

As part of its rulemaking for a uniform fiduciary duty standard for retail investment advice, the SEC also should implement a program of third-party compliance exams of advisers, Ms. White said last Tuesday.

The move would be designed to help the agency's Office of Compliance Inspections and Examinations increase its oversight of advisers. The SEC currently examines about 10% of the approximately 11,500 registered investment advisers each year.

For years, it has requested significant budget increases to hire more adviser examiners, but congressional appropriations have fallen far short.

"It's beyond time to act in this space," Ms. White said at a Securities Industry and Financial Markets Association conference in Phoenix. The goal in using outside examiners is not "to supplant the OCIE work but to supplement it," she said.

THE GOAL in using outsider examiners is not "to supplant the OCIE work but to supplement it."

Mary Jo White
Chairwoman
SEC

GETTY IMAGES

On the sidelines of an Investment Company Institute conference in Palm Desert, Calif., last Wednesday, OCIE Director Drew Bowden declined to discuss the suggestion.

"That's being handled by the chair and the policy divisions," Mr. Bowden said.

Commissioner Daniel Gallagher Jr. has been a vocal proponent of third-party exams, but advisers are mixed about it. Many worry that the Financial Industry Regulatory Authority Inc. could become the third-party examiner.

MISGIVINGS

The Investment Adviser Association has expressed misgivings about the accountability of third parties, costs associated with hiring them and SEC oversight of the outside examiners, as well as the quality and scope of exams.

"We have many serious concerns about the SEC's possibly outsourcing exams to third parties," said Neil Simon, IAA vice president for government relations. "It is critical that the SEC's pri-

Continued on Page 31

Northwestern settles class action for $84M

By Srividya Kalyanaraman

Northwestern Mutual Life Insurance Co. is paying $84 million to settle a class action lawsuit that claimed the firm illegally reduced payouts on annuities it sold 30 years ago.

The suit covered about 4,000 current and 29,000 former owners of annuities, who claimed that the Milwaukee-based life insurer violated the terms of annuity contracts by changing the dividend calculations on deferred and fixed annuities it sold in 1985, according to a report from Reuters.

Investors said that though Northwestern paid dividends on the annuities, the payouts reflected interest on short-term bonds the company had moved annuity assets into, which deprived them of higher long-term potential payouts, according to Reuters.

33K
Approximate number of current and former annuities owners involved in suit

Compensatory damages are estimated at $278 million.

"We've agreed to settle a long-running lawsuit related to a change we made 30 years ago to a type of Northwestern Mutual annuity we haven't sold since 1985," Betsy Hoylman, a spokeswoman for Northwestern, said in a statement.

"We stand firmly behind the actions we took," Ms. Hoylman added. "This settlement does not change our dividend process and will have no material impact on our financial results."

Northwestern distributed $5.2 billion in dividends last year, and it expects that amount to rise to $5.5 billion this year, the company said last October.

Of the $5.5 billion total, about 90% will be paid on whole life insurance, with $320 million on disability insurance, $150 million on term life insurance and $105 million on variable life insurance. The insurer also will pay $45 million on its annuity product line.

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AP IMAGES

Bruce Wilkerson: Former tackle lost $650,000 in alleged Ponzi scheme.

Ex-NFL player loses bundle despite winning $2M award

By Mason Braswell

Resource Horizons Group, a defunct broker-dealer that racked up more than $4 million in unpaid damages from arbitration claims, has to add another $2 million to that list.

Bruce Wilkerson, a former tackle who started for the Green Bay Packers in the 1996 Super Bowl, was awarded $2 million in damages last week after losing $650,000 in an alleged Ponzi scheme carried out by a rogue broker at the Marietta, Ga.-based firm.

But Mr. Wilkerson is not likely to recoup any of the money, which represented a substantial portion of his net worth, according to his lawyer, Adam Gana of the eponymous law firm Gana.

"It's outrageous," Mr. Gana said. "There's virtually no chance that [my client] is going to get paid."

Resource Horizons, which had about 220 brokers, went out of business in November. It had accrued $4 million-plus in judgments against it from two arbitration awards, which it could not afford to pay.

"Funds for payment are not available, which is why the company is being forced to close," the firm said on a filing in its BrokerCheck report. "The clients will have the same right as any other creditors of the company for the funds that are available."

> "IT'S OUTRAGEOUS. There's virtually no chance that [my client] is going to get paid."
>
> **Adam Gana**
> Lawyer for Bruce Wilkerson

The Financial Industry Regulatory Authority Inc. officially suspended Resource Horizons Group in December for failing to comply with a $4 million award and in January canceled its license, according to its public BrokerCheck record.

The firm, which had about $500,000 in excess net capital on hand, has paid only a "very small percentage" of the $4 million award, according to the lawyer in that case, John Chapman.

DENIED COVERAGE

Mr. Chapman said Resource Horizons had applied for insurance coverage around the time of the first complaint about the alleged Ponzi scheme but was denied coverage because of the nature of the fraud.

"This underscores the question of why Finra allows broker-dealers to operate with such incredibly thin resources," Mr. Chapman said. "We're sort of stuck."

The arbitration awards are tied to an alleged rogue broker at Resource

Continued on Page 36

Higher rates could check rally in REITs

Ability to adjust to rate moves linked to lease term

By Jeff Benjamin

A strong rally in real estate funds could be headed for a pause as the market — and investors — start to anticipate rising interest rates.

The broad category of real estate mutual funds, as tracked by Morningstar Inc., gained 28% last year, more than double the 13.7% gain in the S&P 500 Index. It is up 4.46% this year amid the looming threat of higher interest rates. The category nonetheless is far outpacing the paltry 1.94% the S&P had gained through last Thursday.

Historically, real estate investment trusts react negatively to rate hikes but tend to adjust and perform well during longer-term rising-rate cycles, according to Rick Romano, managing director and portfolio manager at Prudential Real Estate Investors.

"When rates are increasing, it means the economy is improving, and that means rents are increasing, occupancy rates are increasing and growth rates for REITs are increasing," he said.

PRICING POWER

Of course, within the real estate space, the categories with the shortest leases have the greatest pricing power advantage.

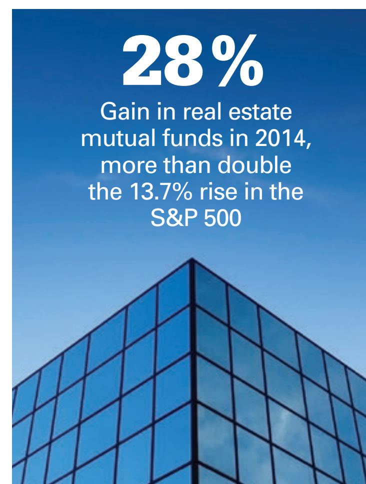
Hotels, which can adjust prices throughout the day, are best positioned to adjust to rising rates, while some nursing home facilities might have leases that are secured for 20 years or more, Mr. Romano explained.

In between those extremes are midrange leases in the form of

Continued on Page 35

28%

Gain in real estate mutual funds in 2014, more than double the 13.7% rise in the S&P 500



White House estimates on DOL rule criticized

By Liz Skinner

The White House is using flawed methodology to assert that abusive trading practices are costing U.S. investors up to $17 billion a year in retirement savings, according to a report released last week by a Wall Street group that opposes toughening rules on brokers.

The 18-page report, commissioned by the Securities Industry and Financial Markets Association, said the estimate that President Barack Obama's administration is using is "simplistic" and is not supported by academic literature.

Additionally, the aggregated number the White House uses includes the entire $600 billion market for annuities in individual retirement accounts, with no reason given for why these assets should be included, according to the report, which was completed by NERA Economic Consulting.

'INCONCLUSIVE DATA'

The White House is using "inconclusive data that draws questionable conclusions" to support a need for tighter oversight of brokers who handle retirement accounts, said Kenneth Bentsen Jr., president and chief executive of SIFMA.

"It's important to lay out all the facts," Mr. Bentsen said on a call with reporters.

The securities industry is expecting the Department of Labor to release a draft rule proposal by early

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Nasdaq: Then and Now

The last time the index hit 5,000, in the year 2000, the technology we used, people we admired and top companies in the stock market were quite different. See how far we've come as the index crossed that mark once again this year.

InvestmentNews.com/nasdaq

Tips for helping clients with intra-family loans

Advisers play an important role in making sure clients' intra-family loans have an appropriate interest rate and do not look like gifts, according to **Nicole Hart**, director of trusts and estates at Sontag Advisory. For more on intra-family loans, see story on Page 20.

InvestmentNews.com/family

Using video to improve client engagement

Advisers can use video to help their clients get to know them and feel a connection even before they walk in the door. Here are some tips on how to best present yourself and your business on camera.

InvestmentNews.com/engagement

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Focus shifts to how we'll spend our time rather than money

Traditional concepts about the good life give way to new ideas

Mary Beth Franklin
On Retirement

My office shelves are crammed with books on how to save for retirement, ensure your money lasts a lifetime, use strategies to protect your nest egg from devastating health care costs, retire wealthy and, failing that, find a great job if you're 50 or older.

But lately I've noticed a subtle shift in subject matters under the retirement literary umbrella. More self-declared authors, many of them financial advisers, Wall Street veterans and former corporate executives, are expounding not on how people should spend their hard-earned money in retirement but on how they should spend their time.

In a new book "Refire! Don't Retire," Ken Blanchard, co-author of "The One Minute Manager," teamed up with psychologist Morton Shaevitz to tell the world how to "make the rest of your life the best of your life." They offer step-by-step checklists based on the personal journeys they took to reignite the emotional, intellectual, physical and spiritual aspects of their later years.

Octogenarian and former Wall Street trader George Rider explains how he got his groove back after 65 in his collection of essays on growing older, "The Rogue's Road to Retirement." Brendan Hare, a retired Fortune 500 litigator who later founded his own law firm, traveled around the country collecting stories from a diverse array of contributors detailed in his book "From Working to Wisdom."

FOOD FOR THOUGHT

Those books provided food for thought as my recently retired husband and I headed south for a week to escape the brutal winter of 2015.

This is my third installment in an ongoing series of observations on life with a retired husband — and what may lie ahead for us.

For background on our saga, see my blog post, "Dispatch from the retirement front."

Mike and I visited some of my older siblings, who appear to be enjoying the good life behind the secure gates of their golf and tennis communities in south Florida.

They and their friends are tan, fit and relaxed. They devote their days to perfecting their strokes on the courts and the greens, lounging by the pool and working out in the gym. They spend their evenings sharing jokes and tales of recent travels over dinner and cocktails with neighbors. They don't seem to need any guidebooks telling them

Continued on Page 35

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

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Former broker wins back $650K award

By Mason Braswell

A former Raymond James Financial Services Inc. adviser who sued the firm for discrimination may finally be able to claim an arbitration award of over $650,000.

The award to Robert Fenyk was overturned in district court last year but reinstated March 11 after a ruling by the U.S. Court of Appeals for the First Circuit.

A panel of three judges unanimously denied the district court's ruling and said the arbitration panel had not exceeded its authority in issuing the original award.

"It has been a long road," said Mr. Fenyk's attorney, Norman Watts, of the Watts Law Firm.

Mr. Fenyk, who ran his own office in Woodstock, Vt., as part of Raymond James' independent adviser network, was fired in 2009. He took the firm to arbitration in 2011, claiming discrimination and retaliation after a supervisor learned about his sexual orientation and status as a recovering alcoholic by reading an email sent by Mr. Fenyk's former domestic partner.

APPEAL AND REVERSAL

The adviser, who became affiliated with Raymond James in 2001, was making an average of $250,000 a year before his termination. In April 2013, the arbitration panel granted Mr. Fenyk over $650,000, about half of what he had requested.

Raymond James appealed to the district court. It argued that the panel had misapplied the law in Florida, where the firm is based, and that the claims had been made beyond the one-year statute of limitations. The district court agreed and vacated the award.

The appellate panel reversed that decision, saying that the court had prudently applied Florida law and that the claim had not been filed beyond the statute of limitations.

A Raymond James spokeswoman, Anthea Penrose, declined to comment.

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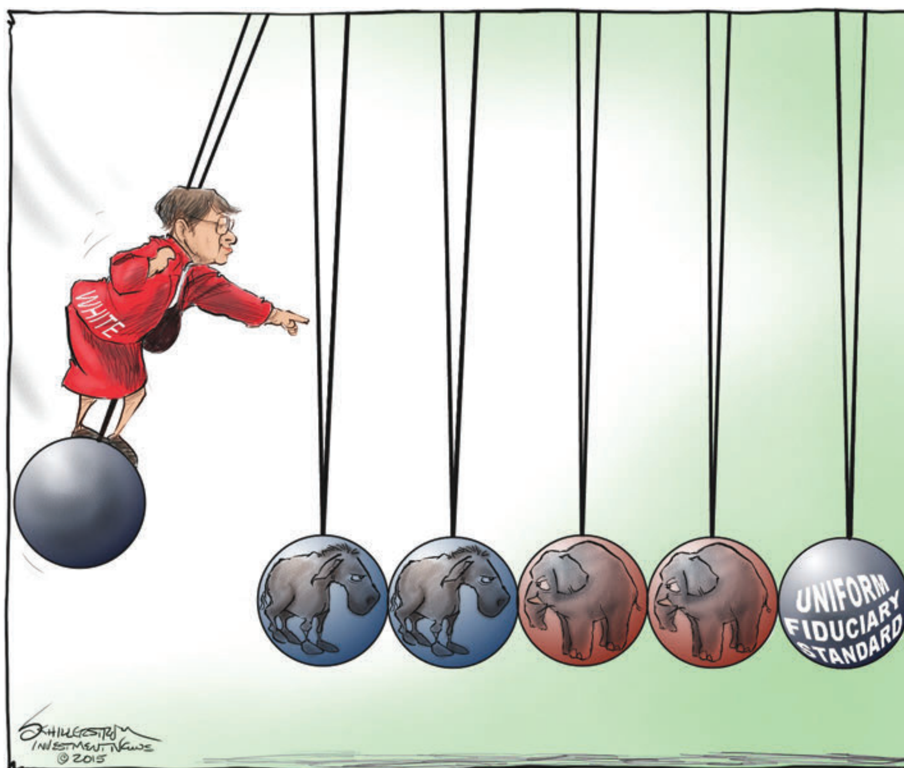
VIEWPOINT

EDITORIALS

Fiduciary rule needs momentum

MARY JO WHITE revealed last week her support for a uniform fiduciary standard for everyone giving retail investment advice. She had kept the industry on tenterhooks since last fall, when she said she would soon announce her position. She stayed mum last month as the White House and the Labor Department moved full bore toward such a requirement in the retirement space.



The chairwoman of the Securities and Exchange Commission even showed reticence — and poise, frankly — when two of her commissioners came out against a fiduciary requirement before one was even on the table. Michael Piwowar seems to favor enhanced disclosures. We all know how much attention investors pay to those and how well they understand them if they do pay attention. And Daniel Gallagher Jr. has become the resident blowhard for the opposition, using phrases like "runaway train" to describe the pending DOL rule and characterizing those who disagree with him as "the nanny state."

So it's about time the chairwoman took the helm and steered the agenda of this supposedly nonpartisan body beyond its present Republican-Democratic split. The two Democrats, Kara Stein and Luis Aguilar, are expected to support a fiduciary standard.

What encourages this publication and advisers working under the Investment Advisers Act fiduciary duty are Ms. White's comments indicating that she would root any new standard in the foundation of that act.

One key aspect is a principles-based approach versus a rules-based one. When principles undergird the mandate, fewer instances of "Well, that wasn't in the rules" are accepted. Instead, people are held responsible for their professional judgments and whether those stem from an allegiance to ethics — in this case, putting clients' best interests first.

DODD-FRANK

Many fear that such a nebulous definition leaves brokers open to lawsuits, but that will depend on how the duty is written. As we've seen in early reactions to Ms. White's comments, industry groups vociferously opposed to a DOL fiduciary rule have been more tempered in their response to an SEC rule. They appear to have faith that perhaps all is not lost, because an SEC rule would be structured according to the congressional authorization in Dodd-Frank — which includes broker protections for charging commissions, selling proprietary products and having a limited continuing duty of care. Don't think for a moment they will step aside while the rule is being developed, though.

> **TOO MUCH** horse-trading will only prolong the status quo, in which it's OK not to put clients first.

Although Ms. White's comments were welcomed by the pro-fiduciary crowd, a few concerns linger.

One concern is whether absorbing a number of elements of the broker business model into a final rule would leave many conflicts in place. A watered-down rule for all is worse than no rule for some.

CLOCK IS TICKING

Another concern is that just beginning discussions two years into Ms. White's tenure suggests that swift action is unlikely. Make no mistake, the clock is ticking. There's no guarantee Ms. White will retain her position when a new administration comes to power in less than two years, whether the president is a Republican or a Democrat. While her statement that "getting the balance right is absolutely essential" is spot on, too much horse-trading would only prolong the status quo, in which it's OK not to put clients first.

One obstacle often cited by fiduciary critics — that the responsibility would prove unsustainably costly, at least in terms of being able to serve less-wealthy clients — has been heard loud and clear. Ms. White expressed her commitment to ensuring that any final rule won't constrain the provision of sound advice to anyone. But, again, looking at real-world practices versus sky-is-falling estimates, many in the lower-income ranks aren't profitable enough to receive sound advice now.

But any additional cost imposed by a fiduciary duty should not be held up as a reason to get away with not acting in any client's best interest. Think of the cost as a down payment on fostering an industry the American public finally trusts. That confidence would benefit not just investors but everyone providing investment advice.

Prepping your firm for sale

Reality usually bites when students graduate from college, begin their careers and realize they're not going to make as much money as quickly as they expected.

For owners of financial advisory firms, reality often bites as they prepare to end their careers and seek to sell their businesses. As reported in *InvestmentNews* last week, advisers aren't going to get as much for their firm as they imagine.

Buyers paid about 2.2 times average revenue in 2014, while sellers sought 2.8 times revenue, according to Cerulli Associates — despite the facts that demand outstrips the supply of such firms and interest rates are low. The latter means firms' present value of future cash flow is high, which suggests prices should be high.

In fact, if interest rates rise and more boomer advisers seek to retire — increasing the supply of available firms — prices most likely will drop even further.

A couple of implications arise from these data.

> **MOST OF** the steps also will enhance the business' operations and success.

First, advisers planning to sell their firm should lower their expectations and, perhaps, adjust their retirement plans. Their nest egg probably will be smaller than they had anticipated.

Second, they should do everything in their power to enhance the value of the firm not only by building solid, enduring relationships with each of their clients but also by ensuring that the firm's other advisers also have strong bonds with clients.

An owner with vigorous relationships across the board can sleep better at night, knowing that neither clients nor fellow advisers will be inclined to leave during the transition, when new owners take over or the firm is merged into an acquirer's practice.

Third, advisers looking to sell their firm must have sound technology and up-to-date relationship management software, to facilitate the new owners' taking over those relationships.

They also need audited financial records so that prospective buyers can easily see profitability and be able to trust those figures.

In short, owners of financial firms who want to sell must do their homework and put in the difficult effort to prepare for sale. They will find that most of the steps in the process also will enhance the business' operations and success.

The steps might not lift the value of their firm to the level of their expectations, but they will maximize the value.

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[1]Morningstar ratings based on the lowest cost share class (Institutional Share Class) for each mutual fund, based on U.S. open-end mutual funds. For a fund with multiple share classes and the same pricing, the share class with the longest performance history is used. Morningstar ratings may be higher or lower on a monthly basis. Morningstar is an independent service that rates mutual funds. The top 10% of funds in an investment category receive five stars, the next 22.5% receive four stars and the next 35% receive three stars. Morningstar proprietary ratings reflect historical risk-adjusted performance and can change every month. They are calculated from the fund's three-, five- and ten-year average annual returns in excess of 90-day Treasury bill returns with appropriate fee adjustments, and a risk factor that reflects fund performance below 90-day T-bill returns. The overall star ratings are Morningstar's published ratings, which are weighted averages of its three-, five- and ten-year ratings for periods ended December 31, 2014. All Lifecycle Funds ranked in the bottom decile of expenses within their respective Morningstar Categories (institutional class, Morningstar as of 12/31/14). Past performance cannot guarantee future results. For current performance and rankings, please visit www.tiaa-cref.org/public/tcfpi/InvestResearch. [2]The Lipper Award is given to the group with the lowest average decile ranking of three years' Consistent Return for eligible funds over the three-year period ended 11/30/12 and 11/30/13, respectively. TIAA-CREF was ranked against 36 fund companies in 2012 and 48 fund companies in 2013 with at least five equity, five bond, or three mixed-asset portfolios. TIAA-CREF Individual & Institutional Services, LLC, Teachers Personal Investors Services, Inc., and Nuveen Securities, LLC, Members FINRA and SIPC, distribute securities products. Annuity contracts and certificates are issued by Teachers Insurance and Annuity Association of America (TIAA) and College Retirement Equities Fund (CREF), New York, NY. Each is solely responsible for its own financial condition and contractual obligations. C21166A ©2015 Teachers Insurance and Annuity Association of America-College Retirement Equities Fund (TIAA-CREF), 730 Third Avenue, New York, NY, 10017.

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VIEWPOINT

Obama's fiduciary plans would restrict access to advice

ROBERT NEUBECKER

The Obama administration is preparing to re-propose a Department of Labor rule to redefine which financial advisers must act as fiduciaries when providing advice to retirement investors. While the proposal is not yet public, indications are that it will be hostile to many advisers and the middle-class clients they serve.

In a speech delivered at AARP headquarters, President Barack Obama stated that some financial professionals are "selling snake oil" and bilking their retirement clients out of billions of dollars per year. By implication, he zeroed in on advisers who receive commissions.

OTHER VOICES
Juli McNeely

His argument is not convincing. Studies show that consumers who receive professional financial advice grow their retirement savings faster than those who go it on their own. Existing laws and regulations protect consumers from fraud and inappropriate practices. The products and services provided by advisers receiving commissions have helped tens of millions of American families obtain financial security and maintain needed income throughout their retirement years.

So why does the administration feel the need for such an aggressive assault on the financial advisory profession? Well, we've been down this road before. And, frankly, the first time was a fiasco for the administration.

WIDESPREAD OPPOSITION

In 2010, the DOL proposed and quickly withdrew a fiduciary rule that met widespread opposition from both Republicans and Democrats in Congress. Former Rep. Barney Frank, D-Mass., said at the time that any DOL fiduciary rule should "not have adverse effects on the choices available to consumers, municipalities and pension plans, among others," and he strongly urged DOL to withdraw the rule.

The forthcoming DOL rule could also reduce consumer choice. While the administration claims that the rule will allow commissions and revenue sharing, it also has implied that the DOL may alter the definition of those terms. For example, commissions may be permitted, but only if they are level across all investment options. Stakeholders were not included in the development of the proposal so we have not seen the exact language. It's disconcerting that the president referred to "backdoor payments," which seems to be a code word disparaging commissions. When you cut through the rhetoric, the rule seems likely to focus on how advisers are compensated, rather than whether consumer interests are served.

To prepare for round two, the administration has done an effective job of divide-and-conquer, pitting one group of financial professionals against another. Registered investment advisers who now operate under a fiduciary standard typically serve wealthier clients and receive fees and/or a percentage of clients' assets under management.

Registered representatives, who would be affected by the new DOL rule, already are tightly regulated by the Financial Industry Regulatory Authority Inc. and closely monitored by their broker-dealers. They must collect detailed information about their clients and clients' investment goals and provide products that are suitable. They often serve middle-market investors and receive commissions.

The pro-fiduciary crowd has boiled the fiduciary issue down to a simple sound bite: "Working in the client's best interests." It's effective and has helped them in the public relations battle over the DOL rule. But, let's not mistake what we're really talking about: The DOL proposal will heap additional regulation on some of the most tightly regulated financial professionals on the planet. And the consequences will impact their clients profoundly.

THE DOL PROPOSAL will heap additional regulation on some of the most tightly regulated professionals.

CONSUMERS DESERVE CHOICES

Many middle- and lower-income American families cannot afford the fees charged by wealth managers. Or they lack the investment assets, often $250,000 or more, which RIAs require for clients who pay a percentage of assets under management. It's not clear under the administration's vision where these Main Street Americans would turn for advice. It's likely they would have nowhere to turn.

The president, in his AARP speech, presented the new layer of DOL regulation as "Wall Street Reform." But the unintended consequences will reach far beyond Wall Street. More than 30 million American households have retirement savings in commission-based accounts, according to research by Oliver Wyman Inc. More than 7 million of those have balances too small to qualify for typical advisory accounts. For the remainder, shifting to fee-based accounts would increase their direct costs by an average of 73% to 196%, according to the research.

There is no "typical" investor. It is important for all investors to have choices about how they obtain financial advice. One investor may be better served paying an upfront fee, while another may fare better paying a percentage of assets under management, while many others may come out ahead paying commissions.

My firm is based in Spencer, Wis., a far cry from Wall Street. I have worked with clients for years whom I may no longer be able to help achieve their retirement goals if the government forces me to switch to a model that doesn't suit their needs or interests. It's a shame, because based on the relationships we've developed, I understand my clients' interests as well as anyone.

Regulations are important to protect consumers and to ensure their continued faith in their financial advisers. But those regulations have to be smart and address real problems. They need to avoid unintended consequences. They should not be based on cynical assumptions that honest advisers need the government to tell them to look after their clients' best interests.

Juli McNeely is president of the National Association of Insurance and Financial Advisors.

Finra revamp makes BrokerCheck easier to use

Examination data, whistleblower link more accessible

By Mason Braswell

With more investors using Finra's BrokerCheck database, the regulator has introduced the first major change in years, in an effort to make it easier for investors to find background information about their broker.

While the new online layout includes all the previous items (the broker's registration history and any customer complaints or disclosure events), it also makes some information more prominent — for example, which examinations the broker has passed.

There's also a link to file a whistleblower complaint and one directing investors to consult with their state securities regulator for a more detailed broker report, referred to as a CRD (Central Registration Depository) Snapshot.

"The information regarding the reps that is provided hasn't really changed from the last version," said Gary Lisker, director of registration and disclosure at the Financial Industry Regulatory Authority Inc.

> "THEY GAVE IT a face-lift, but it's still missing a nose. Why not just put all the information in one place?"
>
> **Joseph Peiffer**
> President
> PIABA

"It's just presented in, hopefully, a more user-friendly way that's easier to understand," he added.

The revisions come as BrokerCheck has grown in popularity, Mr. Lisker said. Individuals finding a broker from a search request rose to to 18.9 million last year from 16.5 million in 2013.

Finra has also considered making it mandatory for brokers to link to the BrokerCheck database from their online public profiles.

CRITICS WANT MORE

The altered format, which Mr. Lisker said Finra had been considering for the last couple of years, appears to represent a compromise with some of the authority's critics.

Investor advocates — particularly the Public Investors Arbitration Bar Association, a group of plaintiff's attorneys — have criticized Finra for not disclosing enough on BrokerCheck and not including data there that are readily available through the CRD Snapshot.

PIABA has pushed for disclosure of test scores and failed tests, for example. The CRD Snapshot includes that input.

Though the scores still won't be disclosed, information is now more visible concerning which exams the broker has passed. It had been somewhat hidden in a separate "detailed report." That report, which included information about a broker's outside business activities and employment history, had to be downloaded as a PDF.

ISTOCK

"The PDF is not the easiest way," Mr. Lisker acknowledged. "If someone got this without any background, sometimes it's hard to make sense of [the document]."

Actually increasing what is disclosed isn't likely to happen soon, however, Mr. Lisker said.

The trend over the years has been to include more, he added, but Finra must receive approval from the Securities and Exchange Commission to present additional information.

"The vast majority of the CRD is on BrokerCheck," Mr. Lisker said. "At this point, we have made the determination that we have to [weigh] the investor value of these things [with] privacy for the industry; just how much bang for the buck do you get out of this, and is it worth putting out there?"

Regarding the whistleblower link, Mr. Lisker said the problem is that many investors don't research BrokerCheck until it's too late.

"A lot of times when people go to BrokerCheck, they already have an issue with a broker," he said. "We'd like them to do it before they have an issue."

PIABA president Joseph Peiffer of Peiffer Rosca Wolf Abdullah Carr & Kane said that though the redesign is nice, BrokerCheck still does not go far enough.

Mr. Peiffer reiterated PIABA's stance that information in the CRD Snapshot should be available through BrokerCheck. That would save investors from having to go to state securities regulators, he added.

"They gave it a face-lift, but it's still missing a nose," he said. "Why not just put all the information in one place?"

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InvestmentNews

IN VOICES

InvestmentNews readers weigh in on top stories

How much do investors really need to know about their advisers?

A story about UBS Financial Services and The Vanguard Group getting fined a total of $850,000 by the Financial Industry Regulatory Authority Inc. for failing to disclose their brokers' bankruptcies, civil judgments and other violations set off a debate online about whether registered reps should have to reveal those events at all. This has been a point of contention in the industry, as some investor advocates have called on Finra to require that brokers disclose even more background events. To read the full story and leave your own comment, visit InvestmentNews.com/backgroundcheck.

"This is absolute BS. What does a broker's credit standing have to do with anything? Let's say there is a lien filed against him. What does this mean? Are clients supposed to avoid him or her? If so, should the broker be allowed to continue to work? Sixty-one percent of Americans have had health-related liens attached to their credit report, thanks to our wonderful health care system. Others threw the keys back at banks on second homes when the markets crashed. What business is it of anyone's?"

— SoloCup

"You must disclose it. Wouldn't you want to know if your doctor botched heart operations? Amazingly, if you pay those liens, they go away."

— Tater Lumkin

"If a financial adviser has blemishes on his financial record, aren't prospective clients entitled to know that? Yes, they are. Clients should be able to ask for details about a tax lien. They should be able to ask about a bankruptcy. There may be acceptable answers; there may not be. Either way, clients should be entitled to the info and the ability to have the conversation. The U.S. system is based on full and fair disclosure. There are plenty of BS rules that have questionable benefit to investors. This is not one of them."

— Michael_Pagano

"They also stay on your credit report for 10 years, and your U-4 forever. And if a doctor botches a heart operation, the AMA doesn't let him keep his license like Finra does."

— SoloCup

"This is regulatory 101. You might want to retake your Series 7."

— TheBlogger`

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Spotlight
Retirement Plan Advisers

INSIDE

"Tibble v. Edison could have huge implications with respect to the statute of limitations and a plan fiduciaries' duty to monitor."
Gerald J. Wernette
Principal/director of retirement plan consulting
Rehmann Retirement Builders

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Diversification through pre-tax 401(k) and Roth 401(k) contributions should be a priority for retirement plans. **Page 16**

401(k) BOND FUNDS GET A MAKEOVER

The once sleepy side of the retirement plan fund menu now features a variety of choices

By Darla Mercado

AMID INCREASED regulatory attention to fund selection, the threat of rising rates and last year's drama surrounding Bill Gross' departure from Pimco, 401(k) bond fund lineups are undergoing a face-lift.

Historically, while plan sponsors and financial advisers have thrown in a variety of equity funds, bonds have been the sleepy side of the retirement plan fund menu.

"When you look at a 401(k) lineup, you have this rainbow of equity funds to choose from," said Tim Courtney, chief investment officer of Exencial Wealth Advisors. "But on the bond side, you'll have a money market fund, a stable value fund and maybe the Pimco Total Return Fund."

That is starting to change.

A recent paper from Towers Watson observed that defined contribution plans have anchored their bond funds to the Barclays Capital Aggregate Bond Index. Using that index as the benchmark leaves the bond fund menu not only heavily slanted toward domestic bond exposure but also U.S. interest rate risk.

As a result, advisers and plan sponsors are seeking bond choices that will zig when the rest of the U.S.-based fixed income market zags. That means that bond funds that were virtually unheard of in the DC space in recent decades — high-yield bond funds, floating rate bond funds and multisector bond fund strategies — are starting to pop up in retirement plans.

Plan sponsors began to ask even more questions about their bond funds when Pacific Investment Management Co. parted ways with its star manager Bill Gross in September 2014. The firm's Total Return Fund, an intermediate bond fund offering, is a staple of retirement plans.

"That incident influenced and informed plan sponsors' thinking about their bond offering," said Lorie Latham, a director at Towers Watson. "We're seeing large plan sponsors explore how adjusting their bond exposures away from core mandates can add value."

"We're seeing large plan sponsors explore how adjusting their bond exposures away from core mandates can add value."

Lorie Latham
Director
Towers Watson

But none of those decisions can be made off the cuff. Retirement plan advisers who are preparing to overhaul a bond fund menu will need to step up their due diligence and get to the heart of what's driving plan sponsors' interest in updating their fixed-income choices.

SELECTION AND MONITORING

In recent years, a volley of lawsuits brought by retirement plan participants against their employers shone a spotlight on the selection and monitoring process that 401(k) fiduciaries undertake when they choose funds. The U.S. Supreme Court will rule on one of the biggest suits, Tibble v. Edison International, in which plan par-

Continued on Page 17

JON KRAUSE

Online: For video on best practices for fund selection and deferral rates, visit InvestmentNews.com/rpa.

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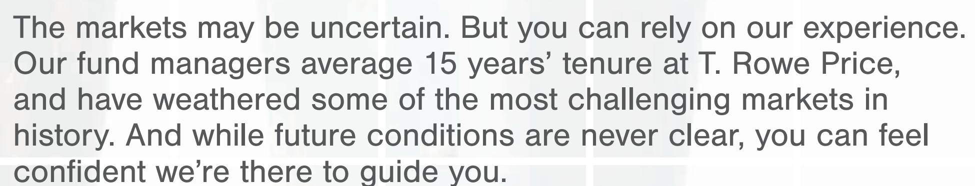

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Retirement Plan Advisers

Preparing for changes

Big changes loom for retirement plan advisers. The Labor Department is poised to move ahead with a fiduciary rule for brokers who work with retirement accounts, and the Supreme Court is set to weigh in on Tibble v. Edison International, a case that centers on whether retirement plan fiduciaries are protected by a statute of limitations on fiduciary violations.

We asked the experts: What best practices should retirement plan advisers make sure they have in place now given the coming shifts? Here's what they said.

"Best practices must meet the more-stringent standards millennials demand over the weaker standards often acceptable to their parents. Take fee and expense transparency. Younger clients will just not tolerate the opaqueness that is the norm in many practices today. They want to know not just what they pay in fees or planning expenses; they want to know why. Clear and complete expense information is not a choice — it's an imperative."

Knut A. Rostad
Founder and president
Institute for the Fiduciary Standard

"Regardless of the outcome of the Tibble case or the new fiduciary rule, the single most important thing advisers can do is to put the best interests of their clients above all else. What does this mean? First, thoroughly learn about your client and their needs. Second, have a prudent process to identify investments that meet your client's needs. Third, have a robust process to monitor those investments."

Marcia Wagner
Managing director
Wagner Law Group

"In this complex and volatile regulatory environment, it is critical that firms redouble their compliance efforts. It is equally important that you get engaged in the legislative and regulatory process. Reach out to your elected officials at the federal and state levels, and share with them information about your business, your clients and how you are helping Main Street Americans save for retirement and a financially secure future."

Dale Brown
President and chief executive
Financial Services Institute

"The Edison International case is, at its essence, about whether a plan is using its purchasing power to purchase the appropriate share class of mutual funds. It is possible, perhaps even likely, that the issue of 'appropriate' share class falls on the shoulders of a fiduciary adviser. As a result, advisers need to make sure that they are evaluating the share classes of the mutual funds they are recommending to ensure that the plan is getting the lowest-cost share class under the circumstances."

Fred Reish
Partner
Drinker Biddle & Reath

"The most efficient way to prepare for potential changes is to eliminate as many conflicts of interests as possible. For years, our profession has relied on disclosure as a way to mitigate conflicts. Going forward, that very well may not be enough. NAPFA has always advocated for a very strong fiduciary standard and it is the reason our members are prohibited from receiving compensation from any recommendation they make to clients, regardless of whether those clients are retirement plan sponsors or individual investors."

Robert Gerstemeier
Board chairman
National Association of Personal Financial Advisors

"Advisers should make sure they put in place a simple rule: Stay informed about industry practices, carefully monitor your client's matters and always act in the best interest of the person for whom you are providing advice."

Jerome J. Schlichter
Founding and managing partner
Schlichter Bogard & Denton

"Tibble v. Edison could have huge implications with respect to the statute of limitations and a plan fiduciaries' duty to monitor. If this case goes the way of the petitioners, then a past decision of a fiduciary that was prudent at the time could come back to haunt them in the future. Plan sponsors and the various service providers they are working with need to take their duty to monitor seriously and not just be checking off fiduciary due diligence requirements for today."

Gerald J. Wernette
Principal and director of retirement plan consulting
Rehmann Retirement Builders

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Fixed-income investing involves risk. The market values of the portfolio's holdings rise and fall from day to day, so investments may lose value. Investments in fixed-income securities are subject to decreasing bond prices as interest rates rise and increasing bond prices as interest rates fall. In addition, a bond's credit rating reflects the issuer's ability to make timely payments of interest or principal, and if the issuer's financial strength deteriorates, the issuer's rating may be lowered and the bond's value may decline. Securities issued by state or local governments may be subject to special political, legal, economic and market factors that can have a significant effect on the portfolio's value.

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Don't forget tax diversification

ADVISERS, plan sponsors and investment gurus preach diversification as a critical factor in investor success. To maximize the return on your portfolio, the argument goes, it's crucial to maintain a proper asset allocation aligned with one's risk tolerance.

But in emphasizing diversification only in terms of asset classes and sectors, advisers may be downplaying another important aspect of a well-diversified investment portfolio: tax diversification through pretax 401(k) and Roth 401(k) contributions.

Choosing the right, tax-smart combination of sources for retirement assets is an important factor in long-term investing success. In addition to current age and future earnings potential, factors such as current versus future tax rates, company matches and assets outside of a retirement plan need to be considered when determining whether to contribute income pretax into a 401(k), or pay taxes upfront in a Roth 401(k).

Educating plan sponsors on the benefits of tax diversification and helping them understand the different needs of employees participating in a company retirement plan also has business benefits. Retirement plan advisers we work with note that this value-add helps them build deeper client relationships with plan sponsors — and it can help participants achieve retirement success.

One critical step in helping plan sponsors unlock the benefits of tax diversification is to establish automatic enrollment plans that utilize both pretax and Roth contributions for newly hired workers. According to Aon Hewitt's "Trends & Experience in Defined Contribution Plans" study, about half of all plan sponsors surveyed allowed Roth contributions, up from just 11% in 2007. The same study found 59% of 401(k) plans have automatic enrollment for participants. But too often Roth contribution options are not used with automatic enrollment.

Automatic enrollment boosts plan participation: The average participation rate in 401(k) auto-enrollment plans is around 85%, while companies without it have participation rates 20 percentage points lower. It's likely plan sponsors would see similar participation gains with automatic Roth contributions.

SEGMENTING PARTICIPANTS

Taking a tax diversification approach also helps advisers and plan sponsors more closely match retirement savings vehicles with the needs of different employee segments. Looking at the macro level of an employee base, different demographic groups will benefit from different money sources. In our research, we have found:

• Younger workers are adopting Roth options at roughly twice the rate of workers in their 50s, according to the Aon Hewitt study. Because they are typically in lower tax brackets, paying taxes now allows contributions to grow tax free for many years until retirement, when most will be in a higher tax bracket.

• Highly compensated employees will be in a high tax bracket, and unless they have sufficient retirement savings to generate an equal amount of income in retirement, they are better off taking a tax deduction now and putting pretax retirement savings into a defined contribution plan.

• Older workers approaching retirement are likely also better off contributing pretax savings because when they enter retirement, their income and tax bracket will probably go down. Therefore, they are better off taking the larger deduction today.

BALANCING ACT

The decision of whether or not to contribute pretax or Roth to a 401(k) hinges on forecasts of current versus future tax rates. The challenge with trying to forecast future tax rates is that many factors can cause them to change, including:

• Life events, such as marriage, having children or divorce

• Changes in one's financial situation, such as a job or salary change or an inheritance

• Governmental changes to tax rules, such as raising or lowering tax rates, changing income brackets or changing tax treatment of distributions in retirement

Since many of these events are impossible to predict, the best option is to diversify and make both pre- and after-tax contributions to best prepare for future uncertainty.

Making it easy to diversify retirement money sources is also critical because of the overwhelming behavioral bias that inertia plays in investing. Most participants are unlikely to switch from pretax contributions to Roth to achieve tax diversification, so we have begun to educate advisers and plan sponsors on the benefit of auto-enrollment in both money sources.

It's a surefire way to ensure that not all nest eggs are in one tax basket.

Robert H. Beriault is chairman and chief executive of Lincoln Trust, a leading national provider of trust and custodial services, including open architecture 401(k) plans.

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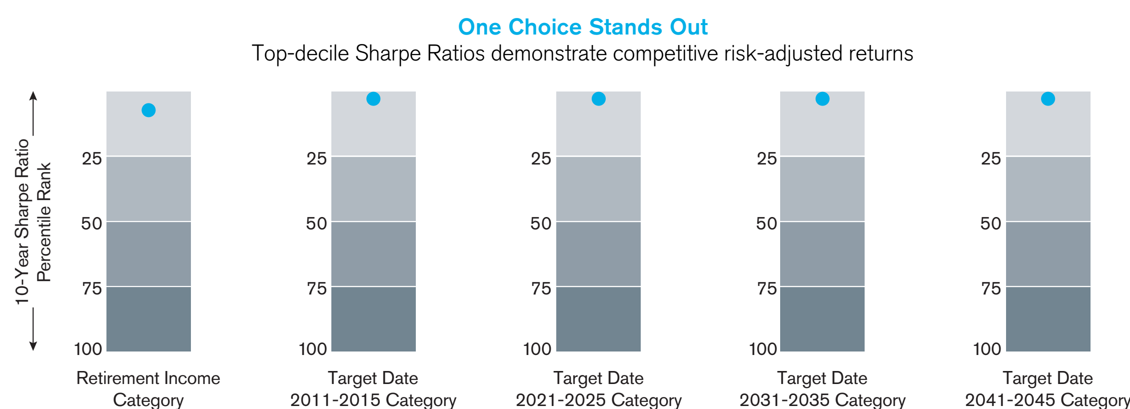

Data as of 12/31/2014. Source: Morningstar.

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Bond funds get a makeover

Continued from Page 12

ticipants accused their employer of choosing costly funds.

Perhaps the most interesting development in the Tibble case was both sides agreeing that fiduciaries have an ongoing duty to make sure investments remain prudent.

In practice, plan sponsors not only need to keep an eye on what's currently in the fund menu, they must also be able to demonstrate how they wound up with those funds. And if they decide to change a fund, they need to document the the rationale behind that decision.

"You don't have to make a change if you look to professionals, you have a conversation with your adviser, and the adviser says he can see where you're coming from and this is why we shouldn't move [from the fund]," said Jason C. Roberts, chief executive of the Pension Resource Institute. "You have to have that conversation, document it, document what you decide and why."

> *"Investment committees like to see a team approach, so one manager leaving doesn't derail the whole fund."*
>
> **Alp Atabek**
> Chief investment officer
> AFS Financial Group

With respect to replacing bond funds, that means advisers need to come up with the right research to back up their guidance.

TURNING POINT

Advisers to 401(k) plans point to the drama around Bill Gross' departure from Pimco as a turning point for bond fund selection.

"It's like Brett Favre was released from Green Bay and went to the Minnesota Vikings," Patrick Morrell, vice president of business development and investments at Ingham Retirement Group, said. "It knocked us back on our heels, and being quick enough to respond with an adequate answer was difficult."

Mr. Morrell initially put Pimco on watch, but wound up suggesting that his 401(k) clients stick with the Newport Beach, Calif.-based firm. Some clients were interested in a change, however, which meant he had to compile a list of about a dozen bond funds and call up other fund managers to explore alternatives.

Alp Atabek, chief investment officer and founder of AFS Financial Group, also recommended that his retirement plan clients with Pimco funds stay put.

Both advisers pointed to the strength of the remaining management team as a factor in their recommendations.

Nevertheless, plan sponsors now are stressing the importance of having a team strategy for bond funds.

"More of the investment committees like to see a team approach, so one manager leaving doesn't derail the whole fund," Mr. Atabek said.

NEW ERA OF BONDS

Diversification is the underlying theme in current bond fund menus as advisers aim to mitigate interest rate risk and broaden exposure beyond intermediate bonds and cash equivalents.

The majority of the industry constructs bond fund menus based on duration, credit risk and the yield the bond portfolio will provide.

Mr. Morrell suggested there is a better way to assess those funds: Consider examining a given fund's risk exposures to cash, Treasuries, corporate bonds and non-U.S. bonds, and use those risk factors to determine how to best build a diverse bond portfolio.

Ingham's 401(k) clients now have complementary bond funds alongside their intermediate bond fund staple, either as standalone options for sophisticated employees or as a component of a customized target-date strategy. "Pimco has a lot of cash and Treasuries, but BlackRock Strategic Income has corporate bonds and futures," Mr. Morrell said. "Together, they provide adequate coverage."

Mr. Atabek, meanwhile, has expanded bond horizons to include multisector bond funds and international bond funds, as well as an intermediate-term bond fund. Normally, these three are actively managed. He also keeps a money market fund or other cash equivalent, and a total bond market index fund, the latter for employees inclined toward passive investing.

"There is something for everyone," Mr. Atabek said.

GUIDANCE AND EDUCATION

The true end client in 401(k)s is the employee. Ms. Latham of Towers Watson noted that when her firm analyzes a portfolio, it considers how a plan's participants have been using the fixed income offerings.

In the interest of keeping things simple for participants, Ms. Latham noted that it's possible to combine a variety of diversified strategies into one customized bond portfolio.

"The participant sees one option, but underlying it are two or three components," she said.

Bond diversification must be paired with participant education, Mr. Morrell said. That can include a breakdown of the funds and how to compare them.

"You're making these [custom bond portfolios and standalone bond funds] available to the participant as tools, but if you don't show them how to use these tools, they're useless," he said.

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1. Source: Morningstar® 01/31/2015. For each fund with at least a 3-year history, Morningstar® calculates a risk-adjusted return measure that accounts for variation in a fund's monthly performance (including the effects of all sales charges), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive a Morningstar Rating™ of 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund and rated separately.) Templeton Global Bond Fund was rated against 297, 233 and 140 funds and received Morningstar Ratings of 4, 4 and 5 stars for the 3-, 5- and 10-year periods, respectively. Templeton Global Total Return Fund was rated against 297 and 233 funds and received Morningstar Ratings of 4 and 5 stars for the 3- and 5-year periods, respectively. Morningstar Rating™ is for Advisor Class shares only; other share classes may have different performance characteristics. © 2015 Morningstar, Inc. All rights reserved. The information contained herein is proprietary to Morningstar and/or its content providers; may not be copied or distributed; and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

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Waning revenues may mean more fees

Advisers could face new charges for services such as practice management and technology

By Sarah O'Brien

LEADERS IN CONVERSATION: CUSTODIANS

If the profitability of the relationship between registered investment advisers and custodians doesn't improve, more advisers could soon find themselves paying an assortment of new fees to custodians.

InvestmentNews hosted a roundtable of top executives from the leading custodians to learn more about the major issues they face.

One of the most pressing is the need to generate profits when traditional revenue sources are drying up and advisers' demand for services is rising, according to participants.

"At some point, I don't know when, there will begin to be a retooling of the revenue engine" for custodians, said Mike Durbin, the former president of Fidelity Institutional Wealth Services.

"The growing list of capital-providers will continue to drive consolidation and growth."

Mike Durbin
President
Fidelity Wealth Technologies

Late last month, the firm's broker-dealer clearing unit was combined under the moniker of Fidelity Clearing and Custody. Fidelity spokesperson Nicole Abbott said in an email that since then, the firm no longer breaks out clients in each channel. But as of last August, Fidelity's custody unit served about 3,000 RIA firms.

In a follow-up statement to the roundtable, Mr. Durbin — who as part of the reorganization was named president of Fidelity Wealth Technologies, a new group — attributed the potential shift to an "increasing divergence between [the industry's] traditional sources of revenue and our evolving areas of investment spend ... such as practice management solutions, that provide added value to advisers."

ECONOMICALLY FEASIBLE

In other words, it has become much harder for custodians to serve advisers in an economically feasible way. That's because custodians traditionally have relied on three revenue drivers: trading volume, income from interest rate spreads on cash and asset growth.

Two of those, trading volume and interest income, have withered over the past six years, making it more difficult to turn a profit in the adviser-custodian relationship, the roundtable participants said.

"Since 2008, asset value is the only thing that has gone up," said Mark Tibergien, chief executive of Pershing Advisor Solutions, in a follow-up interview. Pershing serves 517 RIA firms.

In fact, trading volume — the amount of stocks, bonds and other securities bought and sold by advisers' clients — is going down both in sheer volume and in profitability.

Advisers are trading less on behalf of their clients, and more of the trading they are doing involves passive investments, which tend to be less profitable than active investments.

Morningstar data show that while assets in actively managed funds stood at $9.87 trillion on Aug. 31 compared with $3.98 trillion in passive funds (including index funds), passive funds had an 11% growth rate over the previous year versus just 2% for active funds.

"The more that people go to passive [investing] ... it's less revenue-rich," Mr. Durbin said during the roundtable discussion. "We're very mindful of that custodial mixture that's on the way."

He said that a decade ago, about 80% of industry revenue was based on trading fees.

"Now, 20% is trading and 80% is spread," Mr. Durbin added.

That's not good, especially in an environment in which interest rate spreads for custodians have been squeezed because the overnight federal funds rate has been stuck near zero for the past five years.

The pressure on revenue generated by lower trading volume and interest rate spreads comes as custodians are being asked to provide more services to advisers. In recent years, the major custodians have worked to ingratiate themselves with advisers by expanding their offerings in practice management, compliance and technology — all of which cost money.

"If you don't build capacity, you're not going to grow in a way that you find constructive."

Mark Tibergien
Chief executive
Pershing Advisor Solutions

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It remains to be seen how advisers will react if custodians start tacking on fees for some of those services.

For his part, Ron Carson, founder and CEO of Carson Wealth Management Group, expects to take it in stride — especially if such fees become commonplace.

IMPORTANT PARTNERS

"We all get that we're in business to make a profit," said Mr. Carson, adding that custodians are important partners to advisory firms.

"My clients don't want me not to charge enough, and we don't want custodians not to charge enough, because then it wouldn't be an investment in the future of our business," he said.

In addition to basic asset safekeeping, custodians provide services including technology solutions, continuing education, webinars and conferences.

Some, including several represented at the roundtable, already charge fees to advisers whose assets under management fall below a certain threshold.

Matt Enyedi, an executive vice president and head of RIA Solutions at LPL Financial, said it has moved toward fee arrangements with "business models that aren't profitable, especially at the lower end."

The firm has 322 RIAs on the platform.

In a statement provided later, Mr. Enyedi said, "While in our case only a very small number of firms are charged a fee, it should be noted that the practice of customized fee structures based on the size and complexity of a relationship with a firm is very common in the industry."

11%
Growth rate in passive funds over the previous year, versus 2% for active funds, which are more lucrative for custodians

Pershing, which actively targets RIAs with at least $100 million in assets under management, said it has some fee arrangements, determined case by case, for advisers whose assets under management are lower than the target market.

Meanwhile, Fidelity said that roughly 10% of its client base gets charged an asset-based fee for custody and related services, with either the end-client or the RIA paying the fee.

The firm began charging such fees in 2010 for clients that don't meet a $15 million minimum.

Schwab Advisor Services eliminated custody fees to advisers with less than $10 million in assets under management two years ago.

About 7,000 RIAs custody assets with Schwab.

FOCUSED ON GROWTH

Like Schwab, TD Ameritrade has no minimum AUM.

"When we do engage advisers at the lower end of the asset spectrum, we make sure they have a business plan and are focused on this as their primary occupation and are focused on growth," said Tom Nally, president of TD Ameritrade Institutional, in a phone interview.

About 5,000 RIAs use TD's custody platform.

Almost everyone in the industry is examining the potential for fees' becoming the norm at some point, according to Mr. Tibergien. He said he envisions the emergence of a fixed fee or of a la carte payment for services.

"No one has decisively acted on it, because there are so many variables," he added. "Anytime you change pricing, clients get upset. So to do it, you have to offer added value."

Sarah O'Brien is a freelance writer in Hampstead, Md.

"An asset-based model means those trading less pay more and those trading heavily pay less."

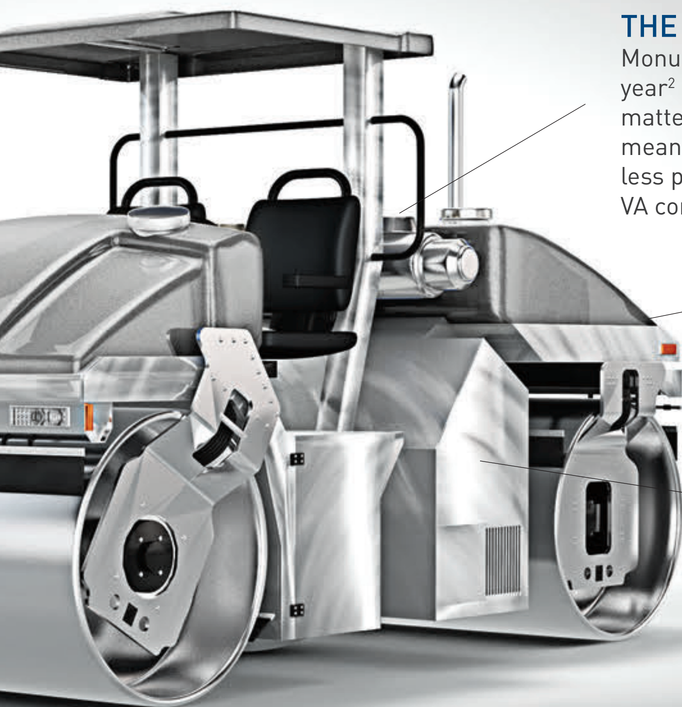
Bernie Clark
Executive vice president
Schwab Advisor Services

"A large block of firms is squeezed because they can't compete on price or service."

Peter Dorsey
Managing director, institutional sales
TD Ameritrade Institutional

"Beating the market or someone else isn't the value proposition that will get advisers to the next level."

Matt Enyedi
Head of RIA solutions
LPL Financial



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Intra-family loans a key wealth transfer strategy

Resurgence coming amid lower rates, but rules do apply

By Darla Mercado

Loans can be a great idea for parents who want to give their children a boost for buying a home or starting a business and who have the assets — just watch how you structure these deals.

Formal agreements known as intra-family loans are seeing a resurgence amid low interest rates these days. The intra-family loan allows for some transfer of wealth to take place between generations without using up the lender's lifetime gift tax exemption, which is now at $5.43 million for 2015. Meanwhile, borrowers are subject to annual interest rates as low as 0.40%, based on the length of the loan.

"It's a nice way to leverage cash from the older generation," said Gavin Morrissey, senior vice president of wealth management at Commonwealth Financial Network. "I see parents giving a child a loan to buy a home or start a business."

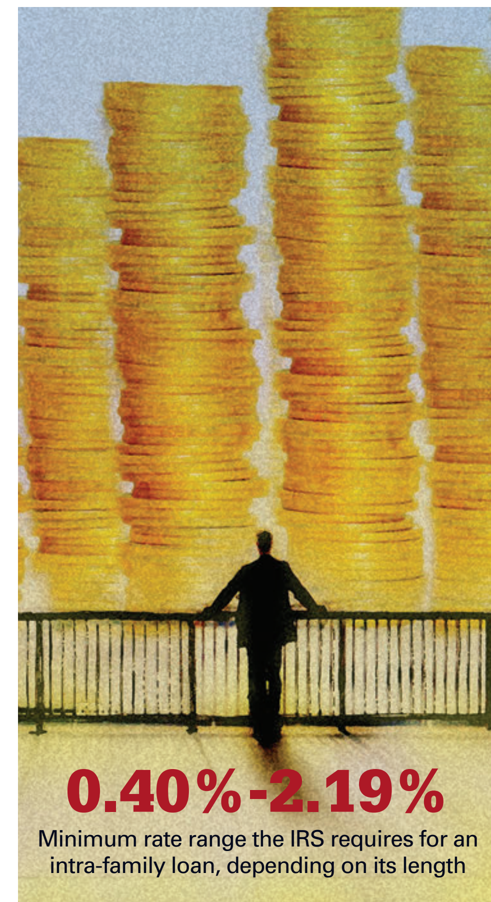
At the end of 2014, Mr. Morrissey helped an adviser structure such a deal for a family that had about $17 million in net worth. The parents had already structured plans for their gift and estate tax exemptions that would use both of those exemptions up, but their two adult sons wanted to open up a business that imported technology hardware.

STARTUP DOLLARS

The parents loaned their sons $180,000 in a midterm intra-family loan to jump-start the business, with an interest rate of about 1.9% — the rate for these loans last November — and they did it without having to disrupt their plans for their gift and estate tax exemptions, Mr. Morrissey said.

But these loans aren't easy to put together, and those who aren't careful will attract the attention of the IRS.

"Theoretically, you can draft the note yourself, but if you needed two people to be on your team, you'd want an attorney to draft the note and an accountant to make sure they know what's going on," said Charles V. Douglas, editor of the National Association of Estate Planners and Councils' Journal of Estate and Tax Planning.



0.40%-2.19%

Minimum rate range the IRS requires for an intra-family loan, depending on its length

The strategy was much more popular as a wealth transfer device when the estate tax exemption was very low, according to Bruce Steiner, an attorney at Kleinberg Kaplan Wolff & Cohen. "You had lots of people who, in the context of a $5 million exemption, didn't seem super-wealthy but were going to be subject to estate taxes, and there were many more people looking to do these [loans]."

Nowadays, it's a boost for borrowers.

To give you an idea of the favorable interest rates for borrowers of intra-family loans: The IRS currently has the key applicable federal rate at an annual compounding rate as low as 0.40% for short-term loans up to three years, 1.47% for midterm loans that span three to nine years, and 2.19% for loans that stretch beyond nine years.

Consider a scenario where a client's adult child is weighing a 15-year fixed-rate mortgage to the tune of 3.16% in annual interest, versus a 15-year intra-family loan from mom and dad at a rate of 2.19% per year. It's clear which option is the most attractive to the borrower.

"It's better than having your child borrow from the bank," said John J. Voltaggio, managing director and senior wealth adviser at Northern Trust Corp.

LEGIT LOAN

But don't mistake this as a wealth giveaway to the younger generation. In order to construct a legitimate intra-family loan that will stand up to IRS scrutiny, advisers will need to bring in legal and tax expertise to consult on the deal.

In order to avoid having the IRS contest the loan, clients need to have a promissory note, create a fixed repayment schedule, set a rate that's either at or above the AFR in effect, secure the debt and demand repayment, according to Mr. Douglas.

Clients should also keep records that reflect that this is a true loan, and borrowers need to make timely repayments and must remain solvent, he added.

Lenders must avoid loan forgiveness and hold borrowers responsible for repaying the amount. "If I make a loan and then three months later I tell you not to pay me back, the IRS will say that from the beginning it was clear that this loan didn't have to be repaid, then this is a gift," Mr. Douglas said.

There are nasty tax consequences for scenarios where the IRS will consider the loan a gift.

If a loan ends up being viewed as a gift by the IRS, it will require the borrower to either use his or her gift tax exemption or pay out gift taxes, currently at a top rate of 40%.

Forgiveness of the loan, on the other hand, is painful for the borrower. He or she is on the hook for income taxes on the amount forgiven, noted Mr. Morrissey.

> PARENTS "ARE PASSING on the value of learning what it is to have skin in the game."
>
> **John J. Voltaggio**
> Managing director
> Northern Trust Corp.

Borrowers need to demonstrate that they can repay the loan, which can be hard if they're funding a business that has a hard time generating cash flow in the first few years. Lenders can help head that off by structuring the loan to permit balloon payments. In the slim first years of a new business, a borrower can make interest-only payments with larger balloon payments on the back end to go toward principal, Mr. Morrissey said.

Further, lenders who are receiving interest payments must report it, as it's taxable to them.

For borrowers who are buying a home, there's the benefit of having deductible mortgage interest on the loan.

At the end of the day, well-to-do clients are teaching a life lesson to their children.

"[Parents] are passing on the value of learning what it is to have skin in the game," Mr. Voltaggio said.

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ADVISERS' BOOKSHELF
Jennifer Openshaw

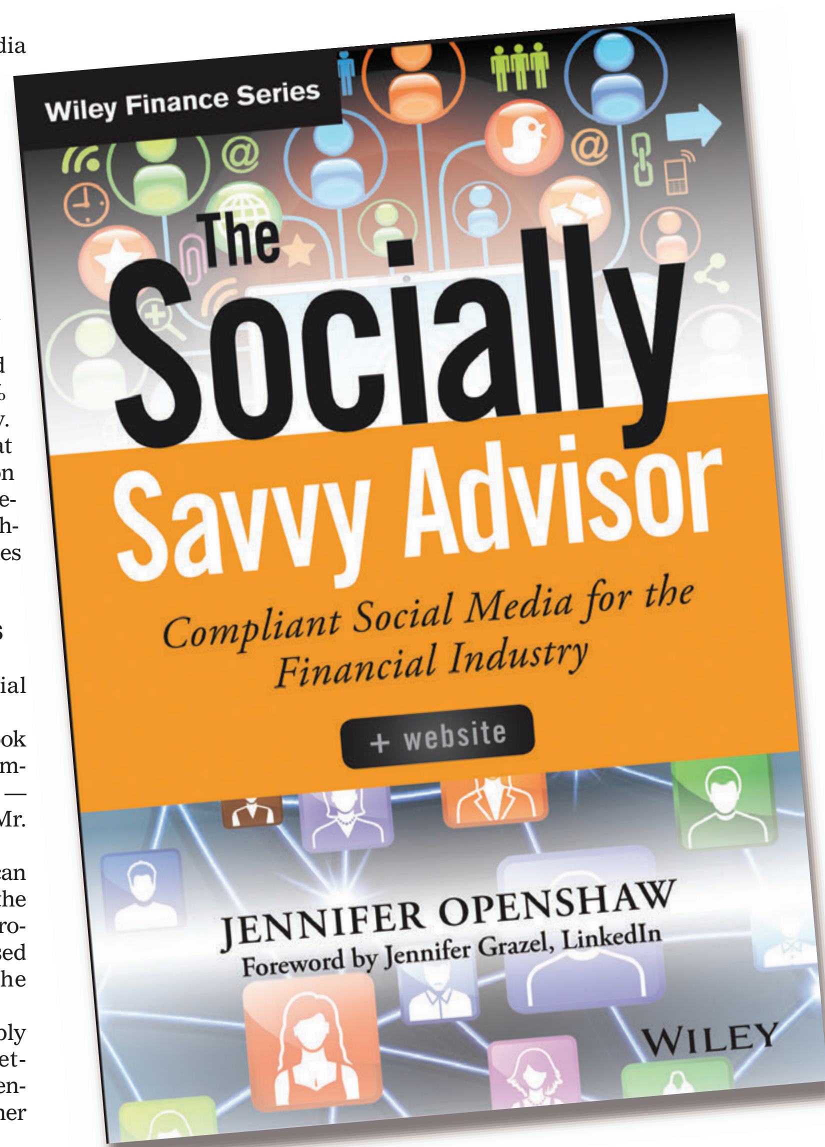
Know the cyberrisks to thwart them

There's more to cybercrime than stealing client data, such as reputational risks to your brand

Cybersecurity has become a buzzword, and it's serious business in financial services. "Levels of cyberrisk that might be fine if you're selling dish soap can create enormous headaches for the financial services sector," says Ed McNicholas, partner at Sidley Austin and co-leader of the law firm's privacy, data security and information law practice.

Cybercrime is the illegal collection or use of data for financial gain. Data provides access to bank, credit card and other financial account information that can be resold or used for identity-theft purposes. For other criminals, it might just be an attention-getting move to demonstrate one's powerful hacking skills. These are called hacktivists, doing it either to disrupt a business or to audition for some greater crime in which they can participate.

"Originally they attacked through email and networks directly," says Blane Warrene, a technology expert and co-founder of the social media archiving service Arkovi. "But now, with so many digital channels, being able to insert malware quietly offers them opportunities to create, in essence, a tunnel to ferret out this data."



And it's not just data at risk. How about your brand? That's right. A wave of attacks can disrupt your business and tarnish your brand publicly.

PricewaterhouseCoopers found that the industry is spending 50% more in 2014 on cybersecurity. Likewise, Deloitte estimates that U.S. financial services firms lost on average $23.6 million from cybersecurity breaches in 2013 — the highest average loss across all industries the consulting firm tracks.

IMPLICATIONS FOR ADVISERS AND ORGANIZATIONS

Let's look at it from a financial adviser's perspective.

"Bad actors or hackers often look to individuals' devices — from computers to smartphones and tablets — as a way into larger networks," Mr. Warrene points out.

While a social media account can be hacked, of greater concern is the way the breach may potentially provide access to the device that is used by its owner to enter and use the social media account.

Access to the device can possibly lead to hacks into business networks, causing the leak of confidential data or, worse, infect many other systems on that network.

For an individual responding to an attack, it is essential not only to recover your account through the procedures available at the social network in question but to also have your device(s) analyzed to ensure there are not any remnants of an attack sitting dormant and waiting for later use.

From an organizational perspective, firms need to consider:

• How they will provide access to social networks.

• How they will manage the publishing workflow and handle engagement to those posts.

• Detailed procedures for securing networks and individual devices, including the heuristic approach to sniffing out possible unpublished malware and attacks.

• Recovery procedures for handling widespread compromise.

A CLOSER LOOK AT THE RISKS

"Professionals have a duty to use robust security against both insider and outsider threats," Mr. McNicholas said.

As an example, when social media profiles reveal too much information, they can be used for social engineering or, worse, to compromise client data. And the reverse can happen: An employee venting on Facebook that he must cancel his weekend plans because the "big deal" in the office must close by Tuesday can be devastating when The Street gets wind of it.

The Federal Financial Institutions Examination Council places the potential risks into three general categories: compliance and legal risks, reputation risks and operational risks. Here's what the agency says:

• **Compliance and legal risks.** Compliance and legal risks are the possibility of enforcement actions and/or civil lawsuits arising out of a financial institution's use of social media. Most regulations, consumer financial protection rules and other laws do not provide exemptions where social media is used.

• **Reputation risk.** There's also the reputational risk arising from negative public opinion in connection with the use of social media.

• **Operational Risk.** Operational risk is defined as risk of loss from inadequate or failed processes, people or systems, which can arise from a financial institution's use of information technology, including social media. Social media use makes firms particularly vulnerable to malware and account takeover, and it needs to be included in the firm's security incident response procedures.

WHAT FINRA AND THE SEC SAY

Both the Securities and Exchange Commission and the Financial Industry Regulatory Authority Inc. released cybersecurity guidance in 2014, setting the tone for examinations and how advisers and firms should set their priorities. At a higher level, the regulators are looking at:

• The security of devices (computers, phones and tablets) and networks

• How client data is handled and protected

• The validity of written supervisory procedures to include a focus on handling incidents

• How business continuity will provide a recovery path from a security incident

• Are firms acquiring cyber-specific insurance coverage

Finra, through its January 2014 Examination Letter, says it's attempting to understand:

• The types of threats

• Where vulnerabilities may exist within firms

• Firms' existing approaches to cybersecurity risks

• Ways to share observations and findings with firms

In April 2014, the SEC held a cybersecurity roundtable in which Chairwoman Mary Jo White underscored the "compelling need for stronger partnerships between the government and private sector" to maintain the integrity of the markets and protect customer data.

The SEC also announced it would be conducting examinations of 50 broker/dealers and RIAs to further understand, among other things: an entity's cybersecurity governance, assessment of risks, and protection of networks and information

In short, regulators are trying to understand where the gaps are and how to address them going forward.

THREE HACKER THREATS

The growing sophistication of technology is accompanied by the danger that tech poses when it's in the hands of sophisticated and unscrupulous people.

What are the kinds of cybersecurity risks advisers might face when operating in the social media world?

Mr. Warrene says attacks break

Shelli Chase, Minneapolis, MN
FSC Securities

I take center stage.

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down into three basic groupings, from obvious to subtle:

1. The malware link. You've probably gotten a direct message from a friend on Twitter. It says: "Check this out!" And you're wondering: "What is this?" This is a malware link: a link that, if you follow it, is tied to something malicious such as a virus that can surreptitiously load onto your device. Often the goal is meant to remain undiscovered, instead of destroying something on your device. Other times it's more sinister. Innocent people have these bots running in the background of their computers, either to collect information or access other computers.

2. The alluring follower. Let's say you discover a follower who appears to have huge influence through the follower's own sizable number of followers, millions. The follower offers a catchy message and link. You think, "Oh my gosh, I've arrived on Twitter!" Yet common sense dictates that only a fraction of people have that kind of following on Twitter. These followers' links are efforts to infect your devices.

3. Direct hacks. An effort to directly hack your system is usually done by what is called a brute force attack. This is where the hacker uses software to try many variations of logins to eventually guess the right way in. The attacks often employ stolen credentials of the victims.

Common sense will keep attackers at bay in the first two cases. In the third case, direct hacks of your social accounts can be defended against through two-factor authentication and using a unique password on each account. The two-factor authentication — available in the settings function of nearly all social media platforms — adds a step to logging in and hampers remote hacks. Generally, once you've entered your username and password, a text message is sent to a mobile device of your choice, and that code is required to finish the login.

WARD OFF RISKS

The bottom line is, if hackers find devices that are unprotected, they have a path to ultimately get to valuable information that can access client accounts.

So, how do you protect against it? Surprisingly, experts agree that even some of the most fundamental moves to protect you, your firm or your clients are not in place at the firm or individual level. Here are some steps that Mr. Warrene suggests firms take:

• **Lock and encrypt computers.** Both the SEC and Finra are examining cybersecurity techniques. On a Mac, you can turn on FileVault so that it encrypts data. On a PC, you can use PGP Encryption from Symantec, among others. For smaller advisers, BitLocker is included in Windows 8 for free. With all of these tools, you're protected when your computer is off and at rest. So, if you're at Starbucks grabbing a cup of coffee and someone walks off with your computer, chances are they'll close the computer and put it under their arm, triggering the encryption. They'll get the computer but not your data.

• **Enable anti-virus software.** Use anti-virus software enabled for automatic updating and automatic scanning as well as automatic quarantine.

• **Use a password manager.** A password manager, such as Password, LastPass or RoboForm, should be a requirement. These provide centralized management of usernames and passwords and allow individuals to securely sync passwords across devices. Avoid keeping password notebooks or Excel files.

THE GROWING SOPHISTICATION of technology is accompanied by danger when it's in the hands of unscrupulous people.

• **Mix passwords.** As noted above, use unique passwords on each of the social media sites. While this might be painful, the peace of mind may be worth it. Also consider changing your passwords twice a year.

• **Create a customer feedback loop.** It's surprising the number of financial firms that do not have an easy way for customers to communicate online about some issue or breach. Consider a message in statements or online directing consumers to alert leaders to possible cybersecurity threats.

• **Protect smartphones and tablets.** These devices also need clear protection, including passwords, required use of a VPN service to encrypt your WiFi connection, and activation of the "FindMe" capability, which allows you to locate that lost or stolen phone and possibly destroy the data.

THE FUTURE

With the increased use of social media and the focus on cybersecurity by regulators, what's next? Among the biggest shifts — and debated issues — is the move to the cloud.

While many in the financial industry view data and website hosting in the cloud as risky, others say the old-fashioned methods pose more risk.

At some point, Mr. Warrene said, "even large institutions won't have full control of all aspects of what they are responsible for, and security risks will be tiered — from individual devices to corporate networks and ultimately to the cloud — which means Apple, Amazon, Google, Microsoft, as well as players like Oracle."

As biometrics emerge, rules and regulations will evolve. For example, passwords are considered protected speech while fingerprints are not.

As we shift from computers to tablets to potentially wearable and interactive computing for business, what risks and liabilities will emerge? If we authenticate through, say, a retinal scan, and a criminal compromises that method, will they have deeper access than ever before?

(Excerpted from The Socially Savvy Advisor + Website: Compliant Social Media for the Financial Industry by Jennifer Openshaw, Wiley, 2014)

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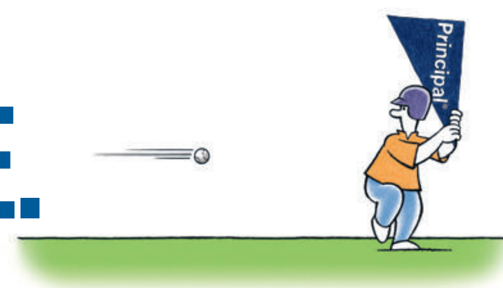

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Principal Global Real Estate Securities Fund	Global Real Estate	10 (221)	1 (153)	N/A
Principal High Yield Fund	High Yield Bond	22 (731)	21 (504)	1 (353)
Principal International Fund I	Foreign Large Blend	3 (750)	18 (583)	40 (313)
Principal LifeTime 2020 Fund	Target Date 2016 – 2020	25 (228)	3 (164)	6 (55)
Principal Real Estate Securities Fund	Real Estate	3 (274)	9 (192)	8 (151)
Principal SAM Conservative Balanced Portfolio	Conservative Allocation	17 (724)	15 (463)	11 (253)

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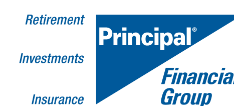

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Stock-picking funds take a nosedive

Fund sales switch toward plain-vanilla, index investing

By Trevor Hunnicutt

If you have an interesting investing idea, try calling Warren Buffett or Bill Ackman, because mutual fund investors just aren't that into you.

In yet another symbol of changing investor appetites, actively managed U.S. stock funds have now completely fallen off the list of the industry's top products.

Of the 25 best-selling mutual funds (and exchange-traded funds) in the U.S., not one employs a portfolio manager to pick U.S. stocks, according to a list by Morningstar Inc. for the 12 months ended Feb. 28.

But it's not just stock pickers who are losing their slots, it's the firms they work for as well. Thirteen of those 25 top funds are managed by the Vanguard Group Inc., now the nation's top mutual fund company.

Other managers making the list include top index-tracking ETF sponsors BlackRock Inc. and State Street Corp.

The only actively managed funds currently in the top-seller list do not involve U.S. stocks and benefited from a historic tailwind, the reallocation of money in bond funds after the September 2014 departure of Pacific Investment Management Co.'s co-founder Bill Gross and the largest series of mutual fund redemptions in history.

BLOOMBERG COMPOSITE

BOND FUNDS

The seven actively managed funds in the top 25 include six bond funds that won business as investors pulled $120 billion from the Pimco Total Return Fund (PTTAX), such as the Metropolitan West Total Return Bond Fund (MWTIX), the Dodge & Cox Income Fund (DODIX) and the BlackRock Strategic Income Opportunities Fund (BASIX).

The seventh actively managed fund to make the list is an international stock fund managed by Dodge & Cox.

NOT AFRAID OF STOCKS

It's not that investors are afraid of the U.S. stock market after its steady march upward over six years. In the period that actively managed stock funds have suffered, losing $120 billion over the past year, investors have poured $219 billion into comparable index funds, according to the data.

"You've seen investor interest in passive products, and that's been a trend for a while," said Vincent Loporchio, a spokesman for Fidelity Investments, in an interview earlier this year. "We believe that's a cyclical trend."

> "YOU'VE SEEN investor interest in passive products. … We believe that's a cyclical trend."
>
> **Vince Loporchio**
> Spokesman
> Fidelity Investments

On the other side of the ledger, all but two of the bottom 25 funds are actively managed. The two index trackers that land on that list are the PowerShares QQQ (QQQ) and the iShares 1-3 Year Treasury Bond (SHY).

SPECIALIZATION

Judging by flows, investors choosing active management right now are looking for specialized expertise. Where passive alternative funds took in $4 billion, their actively managed counterparts took in $10 billion. Index-tracking municipal bond strategies won $4.6 billion, but actively managed versions hauled in $34 billion. And allocation strategies, such as target-date funds, continue to command more assets than index-tracking versions, which are relatively newer.

Those are the only areas where active tops passive, at least when it comes to sales. In stock and bond funds, international and domestic, ETF and index-fund wholesalers have been beating their cousins on the other side of the aisle.

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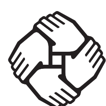

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1. For each fund with at least a three-year history, Morningstar calculates ratings based on a proprietary risk-adjusted return score that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads and redemption fees), placing more emphasis on downward variations and rewarding consistency. The top 10% of funds in each category receive 5 stars, the next 22.5% 4 stars, the next 35% 3 stars, the next 22.5% 2 stars and the bottom 10% 1 star with some adjustments for multiple share class portfolios. **The Overall Morningstar Rating is derived from a weighted average of the 3-, 5- and 10-year ratings (where applicable).** For the 3- and 5-year periods, respectively, the International Growth Fund was rated 4 and 5 stars among 294 and 275 funds in the Foreign Large Growth category for the time period ended 12/31/14. Rating is for Class Y shares and rating may include more than one share class of funds in the category, including other share classes of this fund. **Different share classes may have different expenses, performance characteristics and Morningstar ratings.** Ratings are relative peer group ratings and do not necessarily mean that the fund had high total returns. **Past performance does not guarantee future results.**

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2. Source: IMF World Economic Outlook, 10/9/12 (latest data available).

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With infusion of capital, Orion sets its sights on UMAs

Firm is considering acquiring, partnering with six companies

By Alessandra Malito

Orion Advisor Services, looking forward to an infusion of capital from its impending acquisition by TA Associates, has set its sights on unified managed accounts.

The Omaha, Neb.-based company, a subsidiary of NorthStar Financial Services Group, is considering acquisitions and partnership opportunities with at least six UMA companies. Some of those companies offer the professionally managed accounts and others specialize in the technology behind such accounts.

No deal will be announced before Orion's acquisition by TA Associates is complete on April 30.

> "I THINK [UMAs] will continue to be a growing choice ... if the technology can come through."
>
> **Lawrence Sinsimer**
> Former SVP
> Fidelity

"It's not a big stretch to add that to what they're already doing," said Greg Friedman, chief executive of advisory firm Private Ocean. Mr. Friedman is also president of Junxure, a customer relationship management software provider.

A UMA is a managed account that is rebalanced regularly and holds mutual funds, stocks, bonds and exchange-traded funds in a single account. By consolidating holdings, UMAs feature less paperwork, have simplified fees and allow for more-sophisticated tax management.

DOUBLING DOWN

"Previously we didn't have the capital structure to go out and double down on certain organic investments," said Eric Clarke, chief executive of Orion.

Boston-based private equity firm TA Associates announced in February it was acquiring a majority interest in NorthStar Financial Services and its nine subsidiary providers, including Orion.

NorthStar, with $275 billion in assets under management and more than 650 employees, has a variety of companies with services to help financial advisers.

Terms of the deal were not disclosed.

Since the deal was announced, Orion's financial adviser assets have climbed to $200 billion, up from $180 billion on Jan. 12.

In going after UMAs, Orion is clearly trying to jump on a growing part of the investment management market.

At the end of 2014, assets in UMAs totaled $389.4 billion, up from $200 billion at the end of 2011, according to the Money Management Institute at Dover Financial Research.

Big-name companies also are interested in UMAs. In 2013, Genworth Financial Wealth Management developed a UMA model for its clients. Fidelity and E*Trade launched their UMAs in 2011. TD Ameritrade rolled out a UMA in 2010.

WILL IT DELIVER?

"I think it will continue to be a growing choice among advisers if the technology can come through and deliver the promise it seems to have," said Lawrence Sinsimer, former senior vice president of practice management at Fidelity.

Mr. Sinsimer said the UMA space exemplifies "platformization," a segment that serves as a platform and gives advisers an opportunity to deliver an efficient business model to their clients through customization. Prior to UMAs, accounts were separate. As the business evolved, clients began to see all of their investments in a single account.

Though she doesn't use them herself, Jessica Maldonado, vice president of advisory firm Searcy Financial Services, appreciates the efficiency that comes with UMAs.

Orion, she said, is adept at responding to shifts in product demands from financial advisers.

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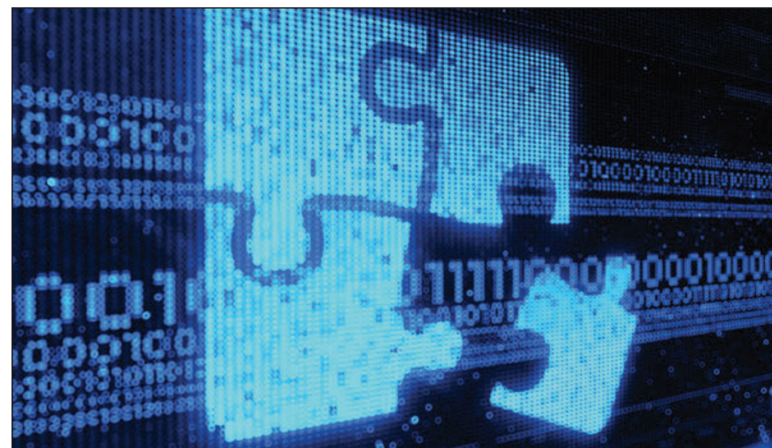

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PRACTICE MANAGEMENT
Joni Youngwirth

Will there be buyers when you sell?

A confluence of factors in the advice industry is prepping a 'perfect storm' for succession plans

In the fall of 1991, a nor'easter barreled through the Atlantic and absorbed Hurricane Grace, creating a devastating storm that wreaked havoc along the East Coast of the United States. Though perhaps not as dramatic as the situation depicted in Sebastian Junger's "The Perfect Storm," a practice management storm is brewing in our industry today, and it could prove dangerous for advisers who are looking to sell a book of business in the coming years.

None of the three components of the storm will come as a surprise to anyone, but their confluence should raise concerns among advisers who don't have a succession plan.

1. Baby boomer advisers (and their clients) are aging. The average age of the roughly 315,000 financial advisers in the United States is 50.9. Forty-three percent are over the age of 55 and nearly one-third are 55 to 64 years old. Many of these advisers' businesses could be described as lifestyle practices, with an emphasis on serving existing clients rather bringing on new ones.

YOUTH SEEKING YOUTH

Even when tenured advisers seek to add new clients in the accumulation stage, they may find that younger clients are looking for a younger adviser who's likely to outlast them.

Pre-retirees and retirees, on the other hand, are relatively easy clients to come by since they actively seek help with retirement distributions. From a revenue-per-household perspective, they're financially attractive clients, but 40-somethings in the accumulation stage are critical for firm growth.

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2. The industry isn't attracting next-gen advisers. For every eight advisers who retire, only three are trained to fill their shoes. And for every graduate of a financial planning program who enters the industry, two advisers become eligible for Social Security.

What's more, the advisers who are entering the industry generally don't start out the way the boomers did. The requisite three years of experience to gain the certified financial planner certification, for example, is a shift that has contributed to the consolidation of practices, and many younger advisers aren't in a position to purchase a book until later in their careers. Established advisers are far more likely to have the capital for a down payment on a practice.

3. The shift from solo to ensemble practices. Although 54% of the industry remains in solo practices, the trend toward ensembles is clear. A solo adviser may sell to another solo adviser, but it's far more likely that solos will be selling to ensembles in the future. And the more times a firm purchases a practice, the more discerning it becomes as a future buyer.

Fifteen years ago, all that glittered was gold when it came to buying an advisory firm. Everyone

THE MORE TIMES a firm purchases a practice, the more discerning it becomes.

wanted to buy a practice, any practice. Today, too many clients, too few clients, too many older clients, or too many clients who generate too little revenue per household are all reasons to either steeply discount value or avoid purchasing a practice altogether. As a result, the 70-year-old solo adviser with 80-year-old clients may well have difficulty finding someone to take over his book.

Of course, the outlook is far brighter if the adviser also has clients' children as clients. Unfortunately, though, that's seldom the case, with a mere 2% of children keeping their inheritances with their parents' financial adviser.

QUESTIONS TO ASK

How prepared are you?

Only 25% of advisers have attended to continuity planning, a serious red flag for the industry. If you're one of the many who haven't yet put a succession plan in place, ask yourself the following critical questions:

- Are you over 50 years old?
- Do you run a solo practice?
- Is the average age of your A and B clients 60 or higher?
- Is the average age of your book climbing as clients pass away and are not replaced by younger clients in accumulation mode?
- Are assets likely to leave your practice when your clients die?

The more times you answered "yes," the more intense the approaching storm may be for you — and the sooner you should take action to avoid becoming a casualty.

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

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ON SOCIAL MEDIA

Kristin Andree

Using LinkedIn to generate leads

Create a system for using the social media site to gain introductions to your target prospects

Gaining introductions to potential clients is an absolute must to grow an advisory practice. Yet many advisers lack a system for doing so. Often, advisers fail to ask for referrals for fear of feeling intrusive, or of creating an awkward situation with their client. With LinkedIn, however, it doesn't have to be that way.

Today, the information we need is literally at our fingertips. To take advantage of this, advisers must develop a system of researching the people they would like to meet and then asking for an introduction. Here are some tips and strategies to get you started.

Identify target markets

The key to strategically growing your practice is having a clearly defined picture of your target markets. What industries do you serve? What titles or positions do your A+ clients hold? In what geographic region do your clients live or work? Any companies where you tend to nest? Once you are clear on these pieces, the strategies that follow can easily be put into practice.

Develop a solid profile

Most clients and prospects research you online before meeting you, so it is critical to have a solid presence that shows them you are approachable and knowledgeable.

Use your LinkedIn profile to position yourself as an expert. Talk specifically to your target markets and share with them how you can help solve their particular financial pain points. Leverage LinkedIn's long-form post feature by regularly sharing valuable and relevant information to stay top of mind with clients and prospects.

Broaden your search

If you have a strong, mutually beneficial adviser-client relationship, most clients are willing to introduce you to their circle of friends and professional connections. Use the advanced search feature on LinkedIn to locate second-degree connections fitting your target market (industry, title, company, geographic region, etc.).

Depending on the number of referrals your practice needs to grow, I recommend you (or your staff) make this a weekly or monthly task. Identify A+ prospects you would like to meet and jot down your common connections.

Next, call your connections and be very transparent about why you are calling. Let them know you were researching people on LinkedIn who you would like to meet and came across someone they knew. Ask them for more information about the prospect.

If your connections know the person well, and feel he or she is a good prospect for you, ask if they would be willing to provide an introduction or if they would have any objection to your mentioning that you know them when you give the prospect a call.

There will always be a handful of clients who may feel uncomfortable referring you. If that's the case, give them an out — but, don't let one "no" keep you from asking others. Always remember, you don't get what you don't ask for.

Join targeted groups

LinkedIn groups provide a great opportunity to connect and engage with professionals in your markets. Take time to perform a search for groups fitting your target markets (small business owners, physicians, etc.). If your practice is specific to a certain geographic region, search by state or region as well.

Once you find a group with members who fit your market, join the group. As a member, you will now be able to see a list of other members. Take time each week to dig deeper into the group. Which of the other members would you like to meet? Do you have shared connections who can introduce you? If so, reach out to them, as you did with the prospects you identified via the advanced search.

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If you don't have a shared connection, send a personalized message introducing yourself and mentioning the group. State how you could be a resource to them (speaking specifically about how you help professionals in that market), and sharing any relevant information you may have (white papers, blogs, links to websites, etc.).

Leave it up to them to respond — don't chase. If they reply showing interest, continue the conversation and work to secure a face-to-face appointment with them. If not, continue your search.

This is a bit more of a "cold approach," but is a solid one to use if there is someone you would really like to meet, but are lacking a common connection who can make the introduction.

Kristin Andree is president of Andree Media & Consulting.

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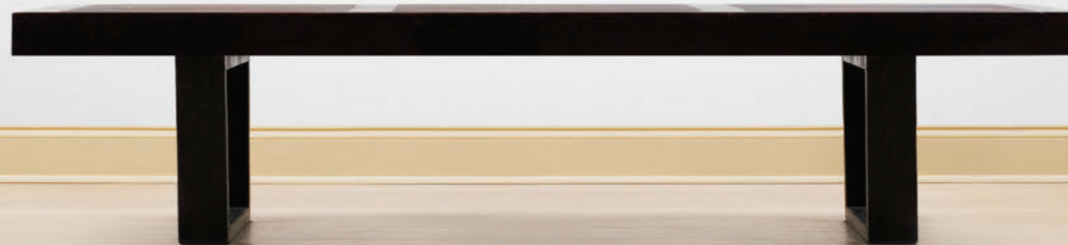

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Americans acting responsibly?

Paying down mortgages and saving more may be harming the economy

By Bloomberg News

In the last year, unemployment dropped, stocks reached record highs and gas prices plunged. Americans got richer, so what did we do to celebrate? We paid down our mortgages.

As the net worth of U.S. households rose 5.2% last year, to $82.9 trillion, new Federal Reserve data show the value of outstanding mortgages fell slightly in the same period. Homeowners now own 54.5% of their real estate, up from less than 40% three years earlier.

Meanwhile, most other kinds of debt are up only slightly. The Fed's measure of consumer credit rose $218.4 billion last year, to $3.3 trillion. The strongest growth in debt is confined to two areas — student loans and auto loans — which accounted for more than 80% of the rise.

BULL MARKET FRUGALITY

Americans also saved more last year, adding 6% more cash to bank and money-market funds, Fed data show. Stock and mutual fund assets also rose along with the bull market.

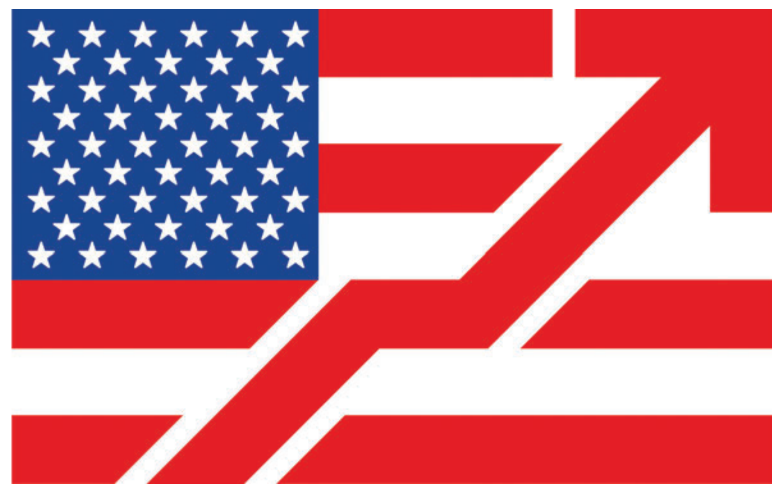
Homebuilders and retailers, of course, would prefer that consumers start spending that money on new homes and better wardrobes, either of which would accelerate the economic recovery.

The rate of homeownership is at a 20-year low, according to data from Bank of America. It's even worse for young people: The rate for those in their early 30s has dropped to 47.1% from 57.4% since 2004.

"The mortgage market is functioning almost as if Lehman Brothers just collapsed," said Michael Englund of Action Economics.

If banks started lending more freely, or millennials started house-hunting, the economy would get a big boost. Then again, consumers' sobriety is also a sign that the U.S. economy may have years more to expand before the risk of a recession, said OppenheimerFunds economist Jerry Webman.

"We're not getting to the point of excess," he said.



6% Increase in Americans' cash savings in banks, money-market funds last year

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Edward Jones uses job simulation tool in hiring process

Allows firm to assess how candidates will interact with clients

By Liz Skinner

Edward Jones has eliminated personality testing as part of its process to find the best financial adviser candidates. Instead, it's finding more success with a 16-step hiring process that includes a "day in the life" simulation.

The St. Louis-based brokerage requires those hoping to become an Edward Jones adviser to complete a four-hour virtual assessment in which the firm observes the candidate's abilities to communicate with clients and think on their feet, said John Rahal, head of financial adviser talent acquisition.

One of the simulations requires aspiring employees to handle a "client" who is upset about an investment.

"We create an environment that allows us to observe the applicant's competencies and allow them to experience what a day in the life feels like," Mr. Rahal said.

ADVISER RETENTION

He said it's too early to fully evaluate the tool, which the firm started using a few years ago, but there appears to be an increase in retention of advisers who went through that process.

"So either the assessment results demonstrated we didn't have the right candidate, or the candidate went through it and said this just isn't the career for me," Mr. Rahal said.

Either way, it's much cheaper to discover someone's not a match before they are hired and trained.

Edward Jones hired 3,112 financial advisers last year after it received 42,000 inquires about the firm, and invited 16,000 people to apply. About 4,500 were given the virtual assessments, according to Mr. Rahal.

The firm, which has about 14,000 advisers, plans to hire another 3,000 advisers this year.

But the task is formidable, given that the number of advisers in the industry is shrinking.

"There is a significant battle for talent among all industries," Mr. Rahal said. "The dimension is generational, as 44 million Generation Xers are replacing 72 million baby boomers."

> "WE CREATE an environment that allows us to observe the applicant's competencies."
>
> **John Rahal**
> Head of financial adviser talent acquisition
> Edward Jones

Attracting career changers is a significant part of Edward Jones' recruiting strategy. However, it's hard to pull the best employees over to the business because when they attempt to resign, their current employers are "doing a full-court press" to get them to stay, he said.

For every 100 people Edward Jones adds to the payroll, the firm actually hires 106, because some individuals are convinced to stay with their current employer.

The typical career changer in Edward Jones' sights is an individual about 38 years old who is making between $75,000 to $125,000 a year in professional sales or service, and other careers where the person has been able to connect with individuals, Mr. Rahal said.

"Typically they've had the life experience needed to build relationships," he said.

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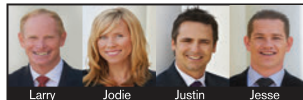

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Furor over robos echoes initial response to tax prep software

As in many other sectors, the rise of new technologies in the independent financial advice industry often leads to forecasts that old ways of doing business will become obsolete. With the proliferation of robo-advisers, no shortage of commentators have suggested the algorithm-driven, online applications are about to turn financial advisers into walking, talking eight-track tapes.

This scenario is not new. Tax advisers experienced similar anxiety during the early days of do-it-yourself tax preparation applications. Based on that experience, the disruption caused by robo-advisers may turn out to be not nearly as widespread or pronounced as the doomsday predictions would suggest.

SERIOUS PLAYERS

Robo-advisers are a significant development in how financial advice is delivered and consumed. In a relatively brief time, a bevy of robo-advisers and robo-adviser-assisted firms have appeared, attracted serious financial backing and gained users. They have moved from being providers of downloadable tools to potentially serious participants.

We have seen this movie before. During the 1980s, self-directed tax preparation programs let people complete their own returns without assistance from tax advisers.

There was plenty of talk that tax professionals would be replaced by DIYers, who now had access to the same software the pros had. TurboTax was flying off the shelves. So-called experts predicted that tax professionals would become the next Tyrannosaurus rex.

Today the tax professional is, miraculously, alive and well. DIY preparation has matured. Lately, it has even been losing market share to living, breathing professionals.

What drives the tax professional's staying power? Above all, the complexity of the tax code, which has only grown more convoluted and arcane, despite perennial calls for reform. Because of this complexity, more consumers — particularly those with complicated financial lives — turn to a professional to complete their return.

The dynamics are similar in the wealth management sector, but even more pronounced. Most people with complex financial lives will not forgo the counsel of a professional.

> **MOST** people with complex financial lives will not forgo the counsel of a professional.

There are simply too many variables to weigh. Those include not only investing but planning for business succession, tuition, retirement, and trusts and estates, as well as the taxes triggered at each step along the way.

The fact is, the financial life of even average Americans is getting more complex.

The Wall Street Journal recently reported that over 58% of retirement assets are now in defined-contribution plans — meaning people have greater responsibility for their own retirements.

With the stakes so high, many Americans will not attempt to go it alone. The penalty for getting it wrong is not just a tax overpayment or a dunning letter from the government. Rather, success or the lack of it can mean the difference between 30 years of living poorly in retirement or 30 years of comfortable circumstances.

LEVEL OF GUIDANCE

The jury is still out on whether robo-advisers can provide the same level of guidance human advisers can. I concede that robos will be able to give general allocation and model recommendations, but I haven't seen much beyond that. Nor have we had an opportunity to view their performance in a downturn.

Ultimately, the same people who choose to prepare their own tax returns will be the target market for robo-advisers. Robos largely will serve people who hold fewer assets and face fewer intricacies. While robos will fill a need for those do-it–yourselfers — just as TurboTax did — those who choose to use a financial professional to provide custom advice will continue to do so.

In the long run, Americans will continue to recognize the value of a human guide to help them plan for and cope with the rising complexity in all their financial matters. Professionals who can marry tax advice with financial advice will have a dual advantage — and will have no trouble co-existing peacefully with the robos.

Roger Ochs is president and CEO of HD Vest Investment Services.

Managed-account fees don't budge

Steady pricing contrasts with decline in cost of underlying investments

By Trevor Hunnicutt

On the whole, fees that mom-and-pop investors pay for mutual funds and similar products have dropped substantially over the past several years. But in at least one corner of the investment universe, fees aren't budging.

The largest and fastest-growing types of managed accounts sold by financial advisers and broker-dealers have dropped at most 6 basis points since the financial crisis, while some fees have risen, according to a report released last week by Cerulli Associates.

Four types of accounts — subadvisory separate, mutual fund advisory, representative as portfolio manager (rep as PM) and rep as adviser — have largely maintained their fees, often as the underlying investments have become cheaper, the report said.

REPLACING LOST REVENUE

The fees go to B-Ds and other managed-account program sponsors as well as to financial advisers, who increasingly are deciding how the money is invested.

According to Cerulli, broker-dealers are under pressure to drive earnings to their parent companies to replace lost revenue from sources such as 12b-1 fees, which are not typically embedded in the cheaper, institutional share classes that advisers prefer.

"Consequently, B-Ds have begun pressuring their advisers to raise the explicit fee for advice," the report said. "Advisers are loath to raise fees on clients, especially since the reason for using institutional share classes is providing a better value. B-Ds are beginning to manipulate the payout grids of advisers to encourage a fee increase."

POORLY INFORMED

As fees move, investors appear to be poorly informed about the cost of financial advice. Citing 2014 data it produced in conjunction with Phoenix Marketing International, Cerulli said 51% of investors either weren't aware what they pay or thought they paid nothing.

Most adviser-serving brokerages offer managed-account programs, but the largest are at the wirehouses, the four firms that control 53% of the assets in the $4 trillion category. In total, the four account types mentioned by Cerulli hold 89% of the assets in the managed-accounts industry, according to MMI and Dover.

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Goldman Sachs launches BDC

IPO points to the growing interest in these high-yielding investments

By Jeff Benjamin

ISTOCK

Ready or not, financial advisers should brace themselves for a fresh wave of business development company sales pitches.

The latest evidence of the push into the category is Goldman Sachs Group Inc.'s initial public offering of the Goldman Sachs BDC (GSBD), a closed-end company that started trading last Wednesday.

It was the first BDC backed by an investment bank to go public in the U.S.

With an initial share price of $20, the offering was expected to raise about $120 million and value the BDC at about $707 million, according to published reports. In mid-morning trading last Friday, the BDC was up 10.4% at $21.52.

Hot on the heels of Goldman Sachs, Credit Suisse Group has filed for an IPO of its Credit Suisse Park View BDC Inc.

Representatives from Goldman and Credit Suisse declined to comment. But their move into the relatively obscure category shows the asset management industry is eyeing the opportunity to attract investors to the asset class.

'MORE INSTITUTIONAL'

"The Goldman offering is a significant continuation of a trend toward larger and more institutional managers' becoming BDC managers," said Todd Owens, co-president of Fifth Street Asset Management, which manages two public BDCs.

"It speaks to the growth of the BDC space," Mr. Owens said. "You'll see across the entire BDC industry, players will get larger, more sophisticated and more institutionally run."

Fifth Street, which has $6 billion under management, runs two public BDCs, Fifth Street Finance Corp. (FSC) and Fifth Street Senior Floating Rate Corp. (FSFR).

BDCs represent portfolios of high-yield private debt, which can be attractive in a low-interest-rate environment. Their yields are hovering between 7% and 10%.

There are caveats, however.

BDCs come in two general flavors, publicly traded and nontraded, and advisers need to know what they're getting their clients into.

Moreover, the yields are high because the underlying portfolios are made up of below-investment-grade debt issued mostly to smaller private companies.

On the publicly traded side, the Goldman offering brings the total number of BDCs to 52, with a combined market capitalization of about $32 billion, which is part of the overall $1.8 trillion private debt market, according to a report by Cliffwater.

Public BDCs trade as stocks, which means plenty of liquidity. But because they are bought and sold throughout the day on exchanges, the share price is often out of sync with the net asset value of the underlying loan portfolio, which is why they tend to pay higher yields.

The nontraded space is smaller, representing only 13 BDCs with a total of about $12 billion worth of investment capital. Liquidity is typically limited, so investors can request money back only monthly or quarterly. That means yields tend to be lower. In addition, they are sold through brokers that often charge commissions of up to 10%.

Brian Mitts, chief operations officer at NexPoint Advisors, said advisers should consider correlations when comparing traded and nontraded BDCs.

"If you're buying a BDC, you're probably looking for noncorrelated credit exposure, but a publicly traded BDC is going to trade more like a stock because it trades on an exchange," he said. "Nontraded BDCs should have close to zero correlation to stocks."

NexPoint is an affiliate of Highland Capital Management, which has $21 billion under management. It kicked off a three-year capital-raising effort in September for its nontraded NexPoint Capital BDC, which has $17 million.

Mr. Mitts said the Goldman launch will help bring attention and add legitimacy to BDCs.

"Institutional players are looking at BDCs as an access point to the retail market," he said. "Now that you've seen Goldman do it, I think you'll see others come in as well."

BDCs have been gaining traction since the financial crisis set the stage for alternative lending sources, according to Mr. Mitts.

SHADOW BANKING

"As we have seen increased regulations around banking and capital markets, it has made it harder for businesses to access public capital," Mr. Mitts said. "That is forcing businesses into the shadow-banking areas," such as BDCs, he added.

With their holdings of high-yield and mostly floating-rate loans, BDCs should benefit from higher interest rates.

"In a rising rate environment, the yields on the underlying assets will increase," Mr. Owens said.

The impact of higher rates is not likely to show up until after a few rate hikes, however.

BDC loan rates are pegged to the London Interbank Offered Rate, which is influenced by the Federal Reserve but set by banks.

The Fed will need to act several times before Libor — currently around 23 basis points — moves above 1%. That's when BDC loans will adjust higher and investors will begin earning more yield.

"You'd have to see an 80-basis-point increase in Libor to have any effect on a portfolio," Mr. Mitts said.

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Third-party exams get a push

Continued from Page 2

macy be maintained in all areas of investment adviser regulation."

But the head of a firm that potentially could conduct investment-adviser examinations is a fan of the idea.

"It's not politically feasible for the SEC to add the resources it needs" for more exams," said Todd Cipperman, principal at Cipperman Compliance Services, on the sidelines of the ICI conference.

"The time has come," Mr. Cipperman said. "I applaud [Ms. White] for recognizing that and understand that she can partner with the private sector to accomplish their ends."

SHOPPING AROUND

Without knowing the scope of the outside exams, it's hard to estimate costs. But Mr. Cipperman said advisers would be able to shop around for their examiners.

"Each firm can select the best resource for them and not be chained to a particular model," he said.

Ms. White acknowledged that establishing third-party exams would present challenges, such as determining who should do them and setting standards for the reviews.

"This is not an easy road, not a quick road," she said, referring to third-party exams and a fiduciary duty rule.

Mr. Cipperman suggested the agency has a model for third-party adviser exams — outside audits of financial statements.

"It behooves them to set standards for third-party compliance reviews just like we have for financial statement reviews," Mr. Cipperman said.

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Our panel will consider the following questions:

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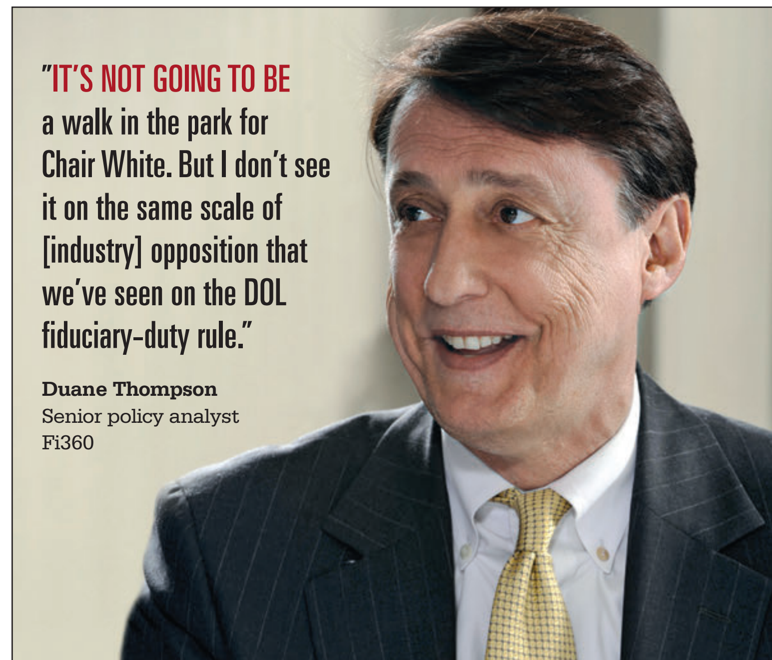
Clock ticking on a fiduciary duty



VINCENT RICARDEL

Continued from Page 1
outlines of the new rule.

“Getting the balance right is absolutely essential,” she said.

The Dodd-Frank financial reform law gave the SEC the authority to promulgate such a rule, which would force everyone providing retail investment advice to act in the best interest of their clients.

‘A BREAKTHROUGH’

Advocates for strengthening investment advice standards hailed Ms. White for indicating the agency would pursue raising the bar for brokers.

“I think it was a breakthrough,” said Karen Barr, president and chief executive of the Investment Adviser Association. “She hadn’t quite stated as clearly as [she did last Tuesday] what her own view on the subject was.”

Ms. White had been promising since November to reveal her position on a fiduciary duty.

“It confirms what she’s indicated in private — that she thinks this is an important issue and one the commission should take up,” said Barbara Roper, director of investor protection at the Consumer Federation of America.

The statement by Ms. White means the SEC will tackle a fiduciary standard for retail investment advice while the Department of Labor proposes a separate rule for brokers giving advice regarding retirement accounts. Ms. White reiterated at the SIFMA conference that the DOL and SEC can pursue separate rules because they operate under different laws.

Ms. White is in a position to be a stalwart for fiduciary duty, said Marilyn Mohrman-Gillis, managing director of public policy and communications at the Certified Financial Planner Board of Standards Inc.

“We think her statement is an indication that she will take a leadership role in advancing a fiduciary standard under Dodd-Frank,” Ms. Mohrman-Gillis said. “The Financial Planning Coalition is grateful that she is making this a priority, and she has our full support.”

The coalition is comprised of the CFP Board, the Financial Planning Association and the National Association of Personal Financial Advisors.

Investment advisers already meet the best-interest standard. Brokers adhere to a suitability rule that requires them to sell investment products that meet a client’s needs but may include higher fees than other products available, for example.

Proponents of a fiduciary duty say it is a critical investor protection.

LIABILITY COSTS

Skeptics worry it will sharply increase regulatory and liability costs for brokers, which would limit their ability to work with lower-income people. They also assert that the suitability standard works well.

“We want to take a look at what the SEC comes up with and judge it based on what we think the impact might be on mid-market consumers,” said Gary Sanders, vice president at the National Association of Insurance and Financial Advisors. “Our members have a relationship-based business model. As a practical matter, [they] are already looking out for their clients’ best interests.”

Groups that attack the DOL fiduciary rule, such as NAIFA and the Financial Services Institute, a lobbying group for independent broker-dealers and advisers, tend to be more restrained about an SEC rule.

That’s partly because the SEC’s work would be done under the congressional authorization in Dodd-Frank, which has protections for the broker business model, such as allowing brokers to charge commissions and sell proprietary products and limiting the timeframe for a continuing duty of care. The DOL, on the other hand, is portrayed as going off on its own.

The fact that Ms. White is pushing ahead with the fiduciary-duty rule nearly two years after she took office is comforting to FSI, which vocally opposes the DOL rule. The group said it showed Ms. White didn’t want to rush into rulemaking.

“This is an encouraging start,” said David Bellaire, FSI executive vice president and general counsel. “We appreciate her careful and measured approach to an important and complex issue.”

The agency also benefits from the fact that brokers dually registered as investment advisers already adhere to a best-interest standard and won’t be shocked if a uniform rule is implemented, said Duane Thompson, senior policy analyst for Fi360, a fiduciary duty training company.

“It’s doable,” Mr. Thompson said. “It’s not going to be a walk in the park for Chair White. But I don’t see it on the same scale of [industry] opposition that we’ve seen on the DOL fiduciary-duty rule.”

Ms. White did not give a timeline for when the commission would propose a rule. She said the next step would be to have in-depth conversations with the four other SEC commissioners. Republican members Daniel Gallagher Jr. and Michael Piwowar have said the agency should not advance a fiduciary-duty proposal.

STRONGER RULE

But that opposition actually frees Ms. White to work with the two Democratic commissioners to formulate a “strong pro-investor rule,” Ms. Roper said.

The Republican members have “made it clear that it’s fruitless to negotiate with them,” Ms. Roper said. “I think she has three votes for a good rule.”

Mr. Piwowar could not be reached for comment. Mr. Gallagher’s office did not respond to a request for comment.

The agency has to address the complexities of how to implement the rule and enforce it, Ms. White said.

Some fiduciary advocates have expressed concern that the SEC will water down the existing fiduciary standard. But Ms. Barr said the SEC chairwoman doesn’t seem to be going in that direction.

“I was pleased that she used the term ‘principles-based’ in her remarks, and that the duty would be based on the Investment Advisers Act duty,” Ms. Barr said. “But, obviously, the devil’s in the details.”

Bloomberg News contributed to this story.

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F-Squared reeling after SEC charges

Continued from Page 1
attempt to look beyond the sales pitch of fund managers, they depend on a complex web of regulators, auditors, outside custodians and others to verify information about those pitching products. In this case, none peered far enough beyond the spectacular claims of a firm that said it could avoid the downside of markets.

“The people that buy the products have been entirely too gullible,” said Tom Brakke, a consultant on investment due diligence. “Imagine yourself at a wirehouse 18 months ago, and you’ve got an incredible volume of new liquid alternative funds coming to market, you’ve got advisers that are demanding them — how much do you have in terms of resources?”

LICENSED ALGORITHM

“I still think there are questions about the whole thing,” said a broker at Wells Fargo Advisors, the $1.4 trillion brokerage, which put F-Squared’s strategies on a watch list.

“If somebody’s going to fabricate a story, they can sell it to anybody,” he said. “It just makes you mad.”

F-Squared was, in part, the brainchild of Mr. Present, a former Putnam Investments executive, who helped start the company in 2006. After two years marketing a small investment strategy, F-Squared licensed the algorithm upon which it would build its success. It began promoting its AlphaSector strategy in October 2008, the same month the S&P 500 index lost 17% of its value.

Given the state of the market, its story was appealing. “A financial advisory firm is betting that investors who use a quantitative formula — rather than emotion and panic — to move in and out of stocks will get through Wall Street’s roller coaster ride with their pocketbooks largely intact,” an *InvestmentNews* article about F-Squared said at the time.

But it wasn’t just its winning strategy that put F-Squared on the map; it was its relationship with Virtus Investment Partners Inc.

In the federal-court complaint against Mr. Present, lawyers for the SEC imply the firm was on its last legs when it won a contract to manage, or sub-advise, mutual funds for Virtus. In the year ended June 30, 2009, AlphaSector produced just $23,102 in fees for F-Squared, and the company posted a $1.7 million loss, the SEC said.

“[Mr.] Present had wooed the fund company for months, making many false and misleading statements along the way,” the SEC said.

Virtus lent credibility to the firm. The money manager’s executives are on a first-name basis with top brokerage houses, making it the linchpin to F-Squared’s adoption by the largest adviser-serving firms, according to two people familiar with Virtus’ broker-dealer relationships.

“The Virtus team and wholesalers, they are a wonderful organization, I have to say,” said one person familiar with the fund-manager relationships of a top broker-dealer. “It’s been a black eye on them for sure.”

F-Squared’s assets would grow more than 24 times over the following two years, to $6 billion, the SEC said.

None of the seven lawyers listed as representing Mr. Present — including partners from the white-shoe law firm Williams & Connolly — returned emails requesting comment. Virtus declined to comment.

A PASSING GRADE

Still wounded today, F-Squared is trying to repair the damage. Ironically, its exchange-traded fund strategy has proved to work largely as advertised.

F-Squared’s flagship Premium AlphaSector Index rose 17.6% over the three years ended Dec. 31. That’s less than the nearly 18.7% posted by its category, but F-Squared achieved those results without exposing investors to wild swings in the market as measured by standard deviation, according to Morningstar Inc.

A number of due-diligence professionals who had looked at F-Squared’s strategy verified that it worked and gave the company a passing grade.

“They worked exactly like we thought they would,” one of them said, noting the model’s successful performance in periods of volatility. “But what does it mean to the bigger picture of what we do, that’s a different story.”

Anticipating the SEC’s charges, investors pulled billions from F-Squared strategies last year, and several broker-dealers continue to prevent advisers from adding new money to the strategies.

In an interview, F-Squared CEO Laura P. Dagan, named to the post last November, said the firm is refocusing its efforts on compliance and its core product line. The firm she took over was too siloed and had “redundancies,” she said.

“I’ve been on a listening tour with our clients, trying to hear their needs, and we’ve also done a deep dive internally,” Ms. Dagan said. “I want broker-dealers and advisers, especially those disappointed in what happened as we went through the settlement with the SEC, to know that we have not just learned lessons but we’re acting on them.”

Ms. Dagan said she is not distracted by “legacy” issues. She said the legal proceedings involving Mr. Present are separate from the firm.

Not all industry observers think F-Squared should be let off the hook.

Some firms that conducted due diligence on F-Squared said it positioned its products too aggressively.

“The problem I’ve always had was, it’s like Lance Armstrong, where not only were they cheating but they were obnoxious about how great their performance was,” said one industry executive. “I don’t see how anyone could call themselves a fiduciary and allocate to Virtus or F-Squared [today].”

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REITs vs. rates

Continued from Page 3

storage businesses with monthly durations and apartment buildings with annual durations.

"The longer the lease duration, the more bondlike the REIT will be," Mr. Romano said.

That is an important consideration for financial advisers allocating client assets to real estate investments for diversification and income — their two main characteristics.

"Bond proxies like REITs could suffer when the Fed raises rates," said Todd Rosenbluth, director of mutual fund and ETF research at S&P Capital IQ. Still, he doesn't see that as a reason to abandon the category.

'NOT TOO LATE'

"It's not too late to get into real estate, because the fundamentals for the U.S. economy are favorable for a number of REIT industries," Mr. Rosenbluth said. "Unlike utilities and other income securities, REITs benefit from an improving economy."

Despite the ebbs and flows of the real estate market over the past several years, many advisers are sticking to the asset class for its presumed diversification features.

"With my clients, I keep real estate typically at about 5% as a diversifier that doesn't correlate to other things in the portfolio and comes with a higher yield," said Chris Chen, owner of Insight Financial Strategists.

Describing REITs as a hybrid of stocks and bonds, Mr. Romano said they are well-positioned to increase dividend yields by as much as 10% this year, versus the average base of about 4%.

But he downplayed their strong performance last year, saying they were catching up from a weak 2013 relative to the S&P.

5% Spread between higher-yielding REITs and 10-year Treasury notes

That year, the REIT category gained 1.6%, while the S&P was up 32.4%.

"Compared to everything else, REITs looked inexpensive," Mr. Romano said. "There was very little supply being added and demand continues to improve, thanks in part to strong jobs growth."

> "WE FLAT-OUT SAY [REITS] will ... act like a stock, especially in a downturn."
>
> **Steve Wruble**
> Chief investment officer
> FolioMetrix

Keith Singer, owner of Singer Wealth Management, advises his clients to hold about 10% in real estate investments. And he is bullish on them because of the wide spread between some higher-yielding REITs and the 2.08% yield on the 10-year Treasury.

"Historically, the spread was 300 basis points, but now you can get 7% yields all day long, and that's a spread of about 5%," Mr. Singer said.

The correlation to stocks could depend on how an investor is accessing real estate.

FADING BENEFIT

While it is true that less-liquid — and typically more-costly — nontraded REITs are expected to be less correlated to equities, that benefit might fade with real estate wrapped inside mutual funds.

"Real estate-oriented mutual funds are used more by retail investors," said Steve Wruble, chief investment officer and head of investment research at FolioMetrix.

The category's performance last year was a reversion to the mean, Mr. Wruble said, adding that some investors might be misusing REITs as a fixed-income proxy.

"We think of REITs as enhanced equity exposure," he said. "They are not a substitute for bonds, even though they're being used that way. With mutual funds investing in REITs, we flat-out say they will most likely act like a stock, especially in a downturn."

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WH figures off: SIFMA

Continued from Page 3

summer that will require brokers offering retirement plan advice to uphold a fiduciary standard that places their clients' interests ahead of their own.

Currently, brokers must meet only a suitability standard of care, which requires only that recommendations be appropriate — rather than the best — ones for client.

In a report released last month, the White House concluded that some brokers boost commissions with excessive trading and expensive investments, and engage in other practices that cost U.S. investors $8 billion to $17 billion annually.

Mr. Obama has directed the Labor Department to move forward with a rule proposal.

A previous attempt to pass such a rule was pulled back in 2011 after it was fought by the brokerage industry, including companies such as Morgan Stanley and Bank of America Corp. Brokers claim the switch would make it too costly for them to serve smaller investors, who would lose access to advice.

CITING U.K. RULE

The SIFMA report contends that the White House is ignoring the impact similar rule changes in the United Kingdom have had on investors there. Brokers stopped serving about 310,000 clients during the first three months of 2014 because their accounts were too small to handle profitably.

Brokers turned away about 60,000 more investors because their balances were too low, the SIFMA report said. It cited studies by Europe Economics analyzing the impact of the U.K. rule that bans commissions to brokers from mutual funds.

"The DOL has said over and over again that it is not going to ban commissions, so why would anyone look at experience that's not relevant to what it's doing?" asked Barbara Roper, director of investor protection at the Consumer Federation of America.

'A FOOL'S GAME'

Assigning a specific number to the harm to investors "is a fool's game," Ms. Roper said, especially as the industry controls access to the data a real analysis would require.

"Reasonable people may disagree over the exact dollar amount of harm, but what's incontrovertible is that brokers are free under existing standards to market themselves as objective advisers while recommending products that put their own interests above clients," she said. "There's a cost to that."

> "BROKERS are free under existing standards to market themselves as objective."
>
> **Barbara Roper**
> Director, investor protection
> Consumer Federation of America

The White House and DOL did not immediately respond to requests for comment.

The SIFMA report also said the White House is failing to value the intangible benefits brokers provide clients, such as encouraging them to increase savings, and doesn't consider that mutual fund fees have dropped since 2000.

"It is notable that this has occurred independently of any explicit government-driven interventions," the report said.

On March 13, DOL Secretary Thomas Perez said he has confidence the agency can complete work on the fiduciary rule strengthening investment advice for retirement accounts before the president leaves office.

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Focus shifting to time from money

Continued from Page 4

how to spend their time during retirement.

But they may represent the last hurrah of this traditional image of American retirement. Most of those snowbirds are in their 70s. Their secure finances — built on company pensions, wise investments and profitable home sales — have allowed them to just have fun.

One of my sister's guests, extolling the virtues of his financial adviser, marveled that his nest egg is bigger today than it was when he retired 15 years ago — despite the carnage of the Great Recession and the annual withdrawals that help him fund his cherished lifestyle.

DIFFERENT VISION

Many baby boomers, the oldest of whom are now in their 60s, may not have the same secure sources of income or the same vision about how they prefer to pass their days.

Personally, I don't want to spend my golden years behind gates. I like my house, my neighborhood and what I do.

Chris Farrell, a senior economics contributor at Marketplace and author of "Unretirement: How Baby Boomers are Changing the Way We Think about Work, Community and the Good Life," argues that increased longevity, careers that are less physically taxing and the need for continued sources of income will create a new model for retirement.

Mr. Farrell suggests that, rather than head south and spend the rest of their lives in adult day camps, boomers are more likely to seek a sabbatical from their primary careers before they figure out what they want to do next.

> **I DON'T** want to spend my golden years behind gates. I like my house, my neighborhood and what I do.

It's the rare boomer who plans to liquidate his 401(k) to start a winery. Instead, setting up a home office and honing existing skills to launch a business or fulfill periodic consulting contracts is appealing, at least in the early stages of a retirement that could last 20 years or more.

That's what I did four years ago when I signed on as a contributing editor at *InvestmentNews*, and I couldn't be happier.

After spending his first eight months in retirement tackling home improvement projects and savoring his new freedom, my husband has accepted a series of writing assignments. It allows him to do what he loves — and to get paid for it.

For some boomers, relocating to a college town, with its opportunities to return to the classroom and enjoy low-cost cultural and sporting events, may be the desired alternative to a gated country club community.

But many of us just want to stay put, at least for now.

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

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Stronghold takes wraps off robo-matchmaker service

By Alessandra Malito

An advisory firm that found itself at the center of controversy last fall because of ties to self-help guru Tony Robbins says its robo-matchmaking service is ready for prime time.

Stronghold Financial LLC announced last Wednesday that it is partnering with online platform Jemstep to launch Portfolio CheckUp. The service analyzes an investor's portfolio, provides a better-performing one for comparison, then matches the investor with an adviser in the area — all within a few minutes.

People accessing Portfolio CheckUp through its website answer questions and provide their portfolio login credentials. The system analyzes their holdings and offers suggestions aimed at enhancing performance.

FOLLOW THE RULES

If investors choose to have their portfolio managed by an adviser, the program will suggest fiduciary advisers.

Portfolio CheckUp has 100 advisers in its network, who pay the San Diego-based company 25% of their fees related to each referral.

Advisers who join the network must adhere to these criteria:

- Represent the legal fiduciary standard to do what's in the client's best interest at all times.
- Don't charge commissions.
- Don't sell proprietary products.
- Have a clean regulatory record.
- Don't charge annual investment management fees of over 1%.

Stronghold got attention last fall after the publication of "Money: Master the Game: 7 Simple Steps to Financial Freedom," (Simon & Schuster, 2014) by Mr. Robbins.

In it, he promotes Stronghold, which was co-founded by Elliot Weissbluth, chief executive of HighTower Advisors, and Ajay Gupta, CEO of Gupta Wealth Management and Mr. Robbins' financial adviser.

Some advisers were outraged when the life and business coach hinted in his book and in interviews that he would become a partner in Stronghold — therefore reaping monetary benefits. Mr. Robbins has since said he will not join it.

Since November, Portfolio CheckUp has garnered about $4 billion in assets.

"It's a great first step," said Scott Bell, founder of registered investment adviser GDP Wealth and blogger at "I Heart Wall Street," who has used Portfolio CheckUp. "It has a lot of the key elements needed for a compelling online experience while also using a real world adviser."

But Shawn Roe, an investor from Virginia who now lives in South Korea, said he tried the platform and would not recommend it.

It contradicts "Mr. Robbins' guidance of not paying an adviser, because a do-it-yourself investment in low-cost index funds will beat a managed portfolio nine times out of 10," Mr. Roe said in an email.

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NFL loss

Continued from Page 3

Horizons, Robert Gist.

In 2013, Mr. Gist agreed to pay $5.4 million to settle charges by the Securities and Exchange Commission that he had run a Ponzi scheme and converted funds from at least 32 customers for his personal use between 2003 and 2013.

He conducted the scheme and made false customer statements via Gist Kennedy & Associates Inc., an unregistered entity not affiliated with Resource Horizons, according to the SEC's complaint.

Mr. Gist could not be reached for comment.

FAILURE TO SUPERVISE

Several customers, including Mr. Chapman's client, filed claims against Resource Horizons and its top two executives, David and Kelly Miller, for negligence and failing to supervise Mr. Gist.

The couple was held jointly liable, along with the firm, for the nearly $4 million in claims from Mr. Chapman's case. The Millers have since filed for bankruptcy, according to court filings.

Though not a lawyer, Ms. Miller represented Resource Horizons in Mr. Wilkerson's case, according to the award. She did not return a call requesting comment.

Ian Falcone, a lawyer for the Millers', wrote in an email that he could not comment because of pending litigation.

Ms. Miller is now registered with Kovack Securities Inc., a broker-dealer that picked up a number of Resource Horizons brokers.

In earlier awards, arbitrators said supervisors at Resource Horizons missed warning signs about Mr. Gist's activities.

"There were sufficient events, actions and behaviors by [Mr. Gist], prior to and during his association with [Resource Horizons Group] that could have been viewed as 'red flags,'" the panel wrote in an arbitration award last year.

Mr. Miller is no longer registered with a brokerage, according to Finra records. He and Resource Horizons have denied not properly overseeing Mr. Gist, according to BrokerCheck.

Neither the Millers nor the firm were named in the original SEC complaint against Mr. Gist.

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