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FEBRUARY 24-28, 2020

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# WHY WON'T FINANCIAL ADVISERS TAKE MILLENNIALS SERIOUSLY?

PAGE 8

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# TopNews

ACCURACY / EXCELLENCE / FAIRNESS / IMPARTIALITY / INDEPENDENCE


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## EDITOR'S NOTE

### Do well, but also do good

This week brought together an interesting confluence of otherwise unrelated emails that reminds me of the impact doing your job well can have on the good you're able to generate.

Last Tuesday, we received an email from a disgruntled reader critiquing us for several things, but primarily, Bruce Kelly's ongoing, hardnosed coverage of bad actors in the advisory industry. The writer expressed disdain for our "enabling" policy. We will continue to proudly present good, accurate reporting that uncovers wrongdoing in an industry that, at its core, seeks to help its clients, but because of money's role in it, can be undermined by malefactors.

GEORGE B. MORIARTY

Meanwhile, my personal inbox is filling up with solicitations to support friends and family in myriad charitable endeavors. One such email reminded me of a conversation I had with Shirl Penney, CEO of Dynasty Financial Partners. We discussed the tremendous amount of philanthropy this industry generates each year, and how we ought to do more to celebrate the good actors who find innovate ways to contribute because they have done well financially.

So, how did these disparate emails connect in my mind? Simply because we can't choose just one path. We need both paths, because only by exposing illicit activities can we truly celebrate the numerous do-gooders who are lost in the din of the less savory side of the industry.


*gmoriarty@investmentnews.com*
*Twitter: @geomoriarty*

WILLIAM GALVIN

# Massachusetts finalizes fiduciary regulations

BY MARK SCHOEFF JR.

**MASSACHUSETTS FILED** final regulations last Friday that would raise investment-advice requirements for brokers in the state but that have been modified to meet some financial industry concerns.

The regulations, which go into effect March 6, would set a fiduciary standard for brokers when they make investment recommendations to customers. They would have to act without regard to their own financial interests. The state will begin enforcement on Sept. 1.

Massachusetts is the first state to issue a final fiduciary rule. New Jersey and Nevada also are considering setting their own fiduciary advice standards.

The Massachusetts rule differs from the Securities and Exchange Commission's Regulation Best Interest for brokers, which will go into force on June 30. Under Reg BI, brokers cannot put their interests ahead of the customer's interests.

#### CENTERPIECE OF REFORM

Reg BI, as it is known, was the centerpiece of the SEC's advice reform regulatory package approved last summer. But Massachusetts and other states say Reg BI doesn't provide enough investor protection.

"Since the SEC has failed to enact a meaningful conduct rule to protect working families from abusive practices in the brokerage industry, it has been left to my office to apply a real fiduciary standard on broker-dealers and agents in Massachusetts," Massachusetts Secretary of the Commonwealth William Galvin said in a statement."Enacting this rule will provide stronger protections for Massachusetts investors by imposing a heightened duty of care and loyalty on broker-dealers and agents. This standard will protect Massachusetts retirees and their hard-earned retirement savings from conflicted investment advice, which has been shown to cost investors billions of dollars each year."

The brokerage industry opposes state-level fiduciary rules, saying they


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# T3 attendees question adviser turnout at conference

Envestnet interim CEO Bill Crager took a moment during his keynote at the 2020 Technology Tools for Today conference to reflect on his company's history with T3.

RYAN W. NEAL

ONTECHNOLOGY

T3 is where the Envestnet team first met Tamarac, the portfolio management technology it would later acquire for $54 million. And T3 is where Envestnet first met Oleg Tishkevich and announced plans to buy the FinanceLogix planning technology.

The marquee event of T3 2019 was Envestnet's partnership with MoneyGuide and the return of eMoney founder Edmond Walters to collaborate on a new, more sophisticated planning tool, paving the way for Envestnet's $500 million purchase of MoneyGuide a month later.

#### A MORE SUBDUED EVENT

It was a nice gesture from Mr. Crager, but the trip down memory lane highlighted a lack of blockbuster news at this year's conference. Whereas past iterations featured major acquisitions or industry-moving new products (Fidelity's multicustodial adviser platform or Black Diamond's sale to Advent come to mind),

JOEL BRUCKENSTEIN


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# Morgan Stanley to buy ETrade for $13B

BY JEFF BENJAMIN

**MORGAN STANLEY** announced last Thursday that it will acquire ETrade Financial Corp. in a $13 billion deal that is certain to reshuffle the deck among financial-services industry giants.

The all-stock deal will create a combined platform with $3.1 trillion in client assets, 8.2 million retail client relationships and accounts, and 4.6 million stock plan participants. This would represent the largest acquisition by a U.S. bank in more than a decade.

Morgan Stanley's acquisition of ETrade is being interpreted as a reflection of the current state of the financial services industry, where fee pressures and regulatory fears continue to drive consolidation.

The all-stock deal, announced just three months after Charles Schwab Corp.'s $26 billion acquisition of TD Ameritrade Holding Corp., looks like another ripple from last fall's wave of brokerages cutting their trading fees to zero.

### 'FEELING THE BERN'

But the rapid pace at which the deal unfolded might also be tied to the surging strength of Vermont Sen. Bernie Sanders in the Democratic presidential primaries.

"This is about how to get away with a merger should Bernie Sanders have a chance at the presidency," said Pauline Bell, an equity analyst at CRFA.

"The financial services industry is definitely 'feeling the Bern,' because they know they have to get these deals done and the window of opportunity is pretty tight," she said.

Ms. Bell said she suspected a deal was imminent given regulatory filings a month ago that indicated increased payouts to ETrade executives in the event of an ownership change.

"Morgan Stanley jumped on this because they know they have to do it now," she said. "When Schwab dropped fees to zero, they poisoned the well for everyone else, so the price point for ETrade is lower now than it would have been a year ago."

### SWIFT NEGOTIATIONS

In a conference call with analysts last Thursday after the deal was announced, Morgan Stanley Chief Executive James Gorman didn't specifically respond to questions about when talks about buying ETrade began, but

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# Morgan takes cue from Merrill with ETrade deal

BY BRUCE KELLY

**WITH ITS PURCHASE** of ETrade Financial Corp., Morgan Stanley is expanding its online and so-called self-directed investment platform for the less than ultra-rich.

In the process, Morgan Stanley, with 15,468 financial advisers, has wound up moving in the direction of its fierce competitor, Merrill Lynch, which has seen its online brokerage platform, Merrill Edge, become one of its fastest-growing business segments, as well as a fertile training ground for young financial advisers.

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# Fed review could be hurdle for Morgan Stanley-ETrade union

BY MARK SCHOEFF JR.

**MORGAN STANLEY'S** acquisition of ETrade Financial Corp. will have to pass muster with the Federal Reserve, but Washington experts foresee the union avoiding regulatory and political roadblocks.

With Morgan Stanley spearheading the $13 billion deal announced on Thursday, the transaction involves a globally significant financial institution, as defined by Financial Stability Board.

That designation for Morgan Stanley triggers a Fed review about whether the combined institution will affect systemic stability, according to Jaret Seiberg, managing director of the Cowen Washington Research Group.

"This is not going to be an easy deal to move through the Federal Reserve," Mr. Seiberg wrote. "We believe Morgan Stanley had to informally run this transaction past regulators before announcing it. That is normal practice as it does not benefit financial stability for the Federal Reserve to reject bank mergers. This would suggest there is a path to approval."

Mr. Seiberg predicted the Fed review would take until the end of the year.

### ODDS ARE GOOD

Saule Omarova, a professor of law at Cornell University, said it is difficult to predict how regulators and legislators will react to the acquisition, but she said the odds are good it will not be stopped by Washington.

"Generally, it is difficult to imagine financial regulators going after Morgan Stanley based simply on the size of the new entity," Ms. Omarova wrote in an email. "This kind of antitrust-type

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# Old brokerage model is dead: Rudy Adolf

BY BRUCE KELLY

**IN THE WAKE** of last Thursday's announcement that Morgan Stanley is buying ETrade Financial Corp. for $13 billion in stock, Rudy Adolf, the founder and CEO of one of the industry's most prominent buyers of registered investment advisers, Focus Financial Partners Inc., revealed his thinking about the deal and his overall distaste for broker-dealers.

Focus Financial, of course, buys RIAs, which are often owned by advisers who got their start at wirehouses like Morgan Stanley. RIAs operate under a fiduciary standard of care for clients while broker-dealers like Morgan Stanley hew to the industry's broader and less stringent suitability rule.

When asked about the Morgan

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# Opinion

EDITORIAL / LETTERS / OP-ED / GUEST BLOGS

# Close the insurance loophole for disgraced brokers

**PEOPLE WORRY ABOUT** things falling through the cracks, whether it's remembering to pay a utility bill or send a birthday card. A barred broker is far too large an object to fall between the cracks, and yet in some cases that's what seems to be happening.

*InvestmentNews* has written repeatedly about the problem of brokers who are disciplined by the Securities and Exchange Commission or the Financial Industry Regulatory Authority Inc. but retain their licenses from state regulators to sell insurance products. Already this year, *InvestmentNews* senior columnist Bruce Kelly has written two articles about such brokers.

In the Feb. 3 issue, he discussed the case of three advisers who were barred by the SEC after having been charged with selling the Ponzi scheme of the Woodbridge Group of Companies, whose former CEO pleaded guilty last summer to running a $1.3 billion fraud. The three brokers earned as much as $2 million each for selling the fraudulent investments. While none were criminally charged, as of a few weeks ago, all of them still had their state licenses: one from Colorado, another from Utah and the third from Texas.

## SECOND INSTANCE

In last week's issue, Mr. Kelly detailed the exploits of Ronald D. Morley, who is based in Maryland. In 2006, Mr. Morley's home state barred him from selling securities for indicating to investors that certain investments were safe, even though some state regulators had ruled otherwise. In 2016, the SEC barred him from working at a broker-dealer or registered investment advisory firm after he convinced 130 clients to invest in a fraudulent stock offering called Summit Trust Co., earning more than $3 million in commissions in the process. In 2018, Mr. Morley was convicted of securities fraud in Kansas in a case that cited $800,000 in losses suffered by four investors in the state. He was given 36 months' probation.

That's quite a list of accomplishments. Yet Mr. Morley is still licensed to sell insurance in Maryland. The state revoked his securities license in the fall, but he has appealed that order.

The fact that salespeople who have been barred by one regulator can continue to get a green light from another regulator is confounding, especially when they were barred for putting people's money, quite possibly their retirement savings, into bogus investments.

Of course, this is partly a reflection of the complexity of U.S. insurance regulation, which occurs at the state level, creating a challenge to coordinate under the different laws and regulations of the 50 states.

## A STEP FORWARD

In a step forward, the National Association of Insurance Commissioners is trying to ensure that state insurance departments are up to date on insurance producers' status with Finra. Last year, the NAIC and Finra reached a memorandum of understanding on information sharing. Now the NAIC's database of insurance salespeople who are licensed by the states includes the active or inactive status of those who are also licensed by Finra. Separately, the NAIC notifies a state of Finra actions involving insurance salespeople licensed in that state.

**THE FACT THAT SALESPEOPLE BARRED BY ONE REGULATOR CAN CONTINUE TO GET A GREEN LIGHT FROM ANOTHER IS CONFOUNDING.**

The NAIC does not have an information-sharing agreement with the SEC because of confidentiality considerations, but the SEC has information-sharing agreements with some states, according to an SEC spokesman.

So, now it's down to the states to filter out the rogues from the ranks of the insurance salespeople they've licensed. While state insurance regulators may not be required to act in lockstep with Finra or the SEC, surely a salesperson who sells investors a Ponzi or other problematic securities shouldn't be permitted to retain a state insurance license and the credibility that confers.

**WE WANT TO HEAR FROM YOU.** Send a letter to the editor with your thoughts about a story we've published, and include your name, title, company, address and telephone number for verification. Keep your letter under 250 words, and email it to George B. Moriarty at gmoriarty@investmentnews.com. All letters will be edited.


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**Chief Executive Officer**
Christine Shaw, cshaw@investmentnews.com

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gmoriarty@investmentnews.com
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Lauren DeRiggi, lderiggi@investmentnews.com
212-210-0154
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212-210-0167
**Business Solutions Manager:**
John Shaughnessy, jshaughnessy@investmentnews.com
212-210-0112
**Business Solutions Manager:**
Jason Anciulis, janciulis@investmentnews.com
312-280-3115
**Account Executive:** Michelle Richard
mrichard@investmentnews.com, 212-210-0238
**Manager US Event Sales:**
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212-210-0432
**Business Solutions Manager & U.S. Events:**
Sabrina Straub, sstraub@investmentnews.com
646-437-7956
**Reprint Manager:** Laura Picariello,
lpicariello@investmentnews.com 732-723-0569
**Sales Operations Manager:** Letitia Y. Buchan,
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**ADVERTISING OPERATIONS**
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**Executive Assistant to the CEO:**
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212-210-0430

**PRODUCTION**
**Prepress/Production Director:** Simone Pryce
**Production Manager:** Paul Vaccari

**INVESTMENTNEWS OFFICES**
**Headquarters:** 685 Third Avenue, New York, NY 10017-4024
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**Head Office:** Bonhill Group, Plc
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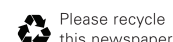

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# INvoices *InvestmentNews* readers react to top stories

MARY BETH FRANKLIN

**IN THIS WEEK'S *IN*VOICES,** we offer a reader mailbag from contributing editor Mary Beth Franklin. Mary Beth is a nationally recognized expert in Social Security claiming strategies. You can look for an update to her e-book – **"Maximizing Your Clients' Social Security Retirement Benefits"** — soon.

### Remarriage and spousal benefits

**Andy:** My client, Mary, age 61, plans to marry a man who is 72 and who is receiving maximum Social Security benefits. How long do they have to be married before Mary can draw on his earnings record while her own retirement benefit continues to grow until age 70?

**Mary Beth Franklin**: Because the soon-to-be wife, age 61, was born after the Jan. 1, 1954, cutoff date, she will never have the option of choosing to claim only a spousal benefit while her own benefit continues to grow. Only people who were born on or before Jan. 1, 1954, have the option of filing a "restricted claim for spousal benefits" at Full Retirement Age (FRA) or later. Whenever Mary files for Social Security, she will be paid the highest benefit to which she is entitled at that age whether on her own record or as a spouse.

She must be married at least nine months and be at least 62 to claim Social Security as a spouse. A spousal benefit is worth 50% of her husband's FRA benefit if she claims at her FRA; less if she claims earlier. The maximum spousal benefit is based on half of a worker's FRA amount, not half of a larger amount that may include any delayed retirement credits.

But if her husband dies first, her survivor benefit would be worth 100% of what he was collecting at the time of his death, including any delayed retirement credits, assuming she is at least FRA at the time she claims survivor benefit; less if she is younger.

### Remarriage and Survivor Benefits

**Anna:** Hello! I have a very high-net worth client who is a Social Security recipient. She was a married for 28 years and her late husband died in 2009. She has been collecting his survivor benefit. She remarried in December 2019 and she is concerned that she is no longer entitled to her late husband's benefit and the Social Security Administration may notify her that she will need to pay them back.
Can you advise us?

**MBF:** If she waited until age 60 or later to remarry, she can keep her survivor benefits even if she is married to someone else. If she remarried before age 60, she will forfeit the right to collect her survivor benefits on her late husband unless her subsequent marriage ends in death or divorce.

### End of "file and suspend"

**Jeffrey:** I attended a conference a couple of years ago and heard you speak and was very impressed with your knowledge of this very complex issue of when and how to claim Social Security.

I have a client who just reached his full retirement age of 66. His wife is age 62 and has worked enough to claim Social Security but her benefit is only about $800 per month. Can he file and suspend his benefit so his wife can get a spousal benefit now? His current benefit would be $2,800 if he takes it today but he plans to continue working and wants to take advantage of the annual 8% per year increase in benefits until age 70.

**MBF:** Unfortunately, the "file and suspend" claiming strategy is no longer an option. That strategy ended after April 29, 2016. To trigger spousal benefits for his wife, your client would have to claim his Social Security.

However, the wife could claim her own reduced benefits now and, later, once her husband claims his Social Security, she may be able to step up to a larger benefit.

Two caveats: If she claims her Social Security early, her retirement benefits will be permanently reduced. Once her husband claims his Social Security, her benefits would be worth less than half of his FRA benefit amount because she claimed her benefits early. Any excess spousal amount, which is the difference between her FRA amount and half of her husband's FRA amount, would be added to her reduced retirement benefit. Spousal benefits are worth up to half of a worker's FRA amount, not half of a worker's age 70 amount.

However, if the husband delays his Social Security until 70 and dies first, the wife will be entitled to full survivor benefits — worth 100% of what he was collecting — if she is at least FRA at the time.

### How Benefits Are Calculated

**Claude:** For purposes of calculating Social Security benefits, I have read that the SSA takes each year of earnings throughout your working lifetime. The question is, what constitutes earnings?

**MBF:** The Social Security Administration uses the top 35 years of average lifetime earnings to calculate Social Security benefits. When you work and pay Social Security taxes, you earn up to a maximum of four credits per year. Most people need at least 40 credits to qualify for Social Security retirement benefits. No benefits can be paid if you do not have enough credits (unless you qualify for benefits on your spouse's record).

SSA relies on gross wages or net self-employment income — both subject to maximum taxable wage base. In 2020, the maximum taxable earnings limit is $137,700. Earnings above that level do not count toward future Social Security benefits.

### Dependent Benefits

**Barbara:** Husband is turning 62 and has health issues. The family needs his Social Security benefits to begin as soon as possible despite the downside of starting benefits before full retirement age. The wife is younger and still working. The couple has a 13-year-old daughter. I understand that the daughter can receive up to 50% of her dad's full retirement age benefit amount until age 18 (or 19 if still in high school). But I am unsure of what the wife's benefit may be. Does her job affect her eligibility for a benefit?

**MBF:** Technically, the wife is also eligible for Social Security benefits, regardless of her age, if she is caring for a dependent child under age 16, subject to family maximum limits. But the wife's earnings could reduce or even eliminate her benefit. She would lose $1 in benefits for every $2 she earns over $18,240 in 2020.

Mary Beth's expert eye provides the *IN* community with invaluable insight into managing these issues for your clients. Do you have a question for Mary Beth or any of our staff writers? Please reach out to them directly, or to Chief Content Officer George Moriarty at gmoriarty@investmentnews.com.

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# STILL OVERLOOKING MILLENNIALS? NOT OK, BOOMER.

## WHY THE FINANCIAL ADVISORY INDUSTRY CONTINUES TO FAIL AT CONNECTING WITH THIS CRUCIAL GENERATION

BY RYAN W. NEAL

Lindsey Loughman should be a model client for any financial adviser looking to connect with the next generation of investors. At 33, Ms. Loughman is a senior manager at a large consulting organization, earns a six-figure income, contributes to her 401(k) and participates in an employee-stock program.

She believes she has too much cash tied up in savings and wants to invest, but her company discourages individual stock buying to avoid insider-trading allegations. She wants advice on how to invest in funds, what to do with her company stock, how to rollover some orphaned 401(k)s from previous employers and how to buy a home in the near future.

"I don't feel like I really have a game plan. I want to talk to someone," Ms. Loughman said. "I know I have options … but [I need help] choosing between them."

What Ms. Loughman wants isn't complicated: a fiduciary adviser with whom she connects on a personal level, who appreciates her financial goals and can implement a plan to achieve them — and correct her when she drifts off course. Trying to find such an adviser, though, has left Ms. Loughman feeling like the investing world doesn't really want someone like her.

Her stories of being offered "bundled services" from her bank and large financial institutions, of being disappointed by robo-advice and not wanting to use her father's adviser because he'll be retired soon and she'll have to start over again, echo those from other high-earning millennials who don't yet have the assets to attract a human adviser, but have needs beyond digital advice platforms.

"If you're not trying to invest $10 billion, nobody wants to spend time with you," said Dean LeNeave, a 41-year-old director of operations for a luxury jewelry company.

Advisers he approached wouldn't go beyond a phone call or offering simple advice he could find himself with a Google search, he said. Mr. LeNeave said he can tell when advisers simply aren't interested in working with him and his wife, Lauren, a 38-year-old customer relationship manager at a high-end fashion brand, but he wants to start the financial planning and investing process now, not in a few years when he's saved up a large sum of money.

"I want somebody who knows us, knows our needs and what we want," Mr. LeNeave said. "You don't start going to a doctor when you have cancer. You go to a doctor when you notice something is wrong."

Many advisers admit they have no solutions for working with these clients – even though they recognize the 73 million people in the U.S. born

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between 1981 and 1996 as being the future of investing, standing to inherit billions from their baby-boomer parents. Those who identify as millennials, some of whom are reaching their 40s now, also have inherent financial challenges unique to their generation, and research shows they are off to a slow start. Most millennials entered the workforce at the height of the economic recession, which has shaped many of their life choices – such as delaying buying a home and having children.

Meanwhile, even though the industry has invested in helping traditional brokers offer financial planning that can connect with millennials, many advisers find it just doesn't fit their business model. Shrinking margins and fee compression are forcing some advisers to give up all small accounts, regardless of age, to focus instead on providing high-touch investing and planning services to their wealthiest, and most revenue-producing, clients.

Also, some advisers say millennials as a group are difficult to work with. Henry Luong Hoang, a certified financial planner with Bright Wealth Advisors, said blogs and online resources often predispose young clients to making poor decisions to beat the market and chase short-term gains.

### UNREALISTIC ABOUT RETURNS

Georgia Bruggeman, CEO and founder of Meridian Financial Advisors, said millennial prospects with whom she's met are often overconfident about their knowledge, unrealistic about returns and have undefined goals.

"Others are unwilling or unable to follow the plan, which is understandable since their lives are in flux and there is so much change during that time," Ms. Bruggeman wrote in an email.

Even some advisers who understand the need find serving millennials challenging.

In 2014, Scott Stratton, a certified financial planner and president of Good Life Wealth Management, established a program offering financial planning to millennials for $99 per month without a high assets-under-management requirement or large upfront charge. As an early adopter, Mr. Stratton thought he could establish his firm as a destination for millennials who get turned away by other advisers. But now he is shifting course.

There are still many obstacles preventing such a program from being sustainable, Mr. Stratton said. Student loan debt restricts the value an adviser can provide, and even a $99 fee is too much for clients investing small amounts of money. Millennial clients hated seeing a monthly fee charged to their credit cards or automatically withdrawn from bank accounts, a client issue Mr. Stratton never experiences when debiting fees from brokerage accounts, he said.

"We complete most of their planning objectives in 12 months and after that it is more difficult to add value," Mr. Stratton said in an email. "And my regulators said I was charging in excess of 3% and refused to accept that this was a planning fee, even when I had clients with zero AUM."

### HIGH TURNOVER

The result was high turnover, with nearly half of clients leaving in 18 to 30 months, said Mr. Stratton, who is keeping the program open for existing clients, but refocusing his practices on serving retiring baby boomers.

"Small clients often take as much time as larger clients but are not very profitable when you consider the number of hours they consume. And with higher turnover, the cost and effort of acquisition can be a losing proposition," he said.

Advisers who have found a business model and path to working with millennials, such as firms in the XY Planning Network, said this attitude risks alienating the next generation from the financial services industry as a whole. According to a Cerulli Associates' survey of people earning at least $100,000, millennials already work with advisers at a lower rate than older generations.

Nevertheless, when asked what they find most difficult about working with advisers, millennials said expense was far and away their biggest concern, said Scott Smith, Cerulli's director of advice relationships.

The key for advisers trying to connect with this group is demonstrating the value of that expense, Mr. Smith said.

"Once an investor has begun an engagement, cost concerns become secondary to finding the right adviser that matches clients' preferences in a variety of ways," Mr. Smith wrote in an email.

Cost was singled out by Rachelle Lindsay, a 32-year-old clinical program manager for a medical device company. Ms. Lindsay and her husband, Adam, a 33-year-old orthopedic surgeon finishing up his residency, want advice on how to best put their income, stock options and money market fund Ms. Lindsay received from her grandfather, toward building wealth, saving for retirement, buying a home and paying off school loans.

They considered robo-advice, but the tech options they looked at couldn't help with the money-market fund or what to do with Ms. Lindsay's company stock options. Mr. Lindsay likes the idea of automating his finances, but doesn't trust everything to an app.

"If there's someone who says they understand [the markets] and how to maximize my investment and how to plan to get us financial planning, that's something that I think would be worth paying for," Mr. Lindsay said.

### ADVICE TOO BASIC

Several of the human advisers with whom they've met have offered such basic advice that the couple couldn't understand why they would pay thousands of dollars for it. Others they've met seemed "sleazy," Ms. Lindsay said.

"I just felt like I was being sold sh-t in every conversation, and I just hate that," Ms. Lindsay said. "And it's your money — not something you would entrust with anybody. It's not buying shoes or even a car. It's your savings."

What's been most helpful for the couple is a financial planner who specifically works with new physicians and came recommended through others at Mr. Lindsay's hospital. He doesn't manage investments but he has helped them save for a home and find disability insurance, which is critical for surgeons in case of injury, Mr. Lindsay said.

> **"WE TREAT OUR CLIENTS LIKE MILLIONAIRES BEFORE THEY ARE."**
>
> PRIYA MALANI, FOUNDER, STASH WEALTH

## OLDER MILLENNIALS

Mario Cacciola, a 40-year-old associate attorney for a large, international law firm, gets cold-called by financial advisers multiple times per week looking to begin a relationship with him now before he climbs the ladder and makes partner. Although many have rubbed him the wrong way, he eventually met one adviser he felt comfortable with. After working together several years, Mr. Cacciola said he appreciates these five things that could help other advisers who are looking to connect with the next generation.

**1. OFFER A PERSONALIZED PLAN, DO NOT SELL ME AN INVESTMENT**

After meeting with many advisers who aggressively pushed investment products, Mr. Cacciola picked one who offered a free assessment of his financial life and presented a realistic plan to achieve his goals.

**2. KNOW HOW TO WORK WITH DEBT**

Part of the plan for Mr. Cacciola accounted for both his student loans and some credit card debt he was working to pay off.

**3. DON'T EXPECT BIG BUSINESS RIGHT AWAY**

For now, Mr. Cacciola's adviser only handles his IRA and a life insurance policy, but he hopes that as his income increases and he eventually becomes a partner, he'll handle his more complex finances. "He wasn't trying to sell me, he was legit trying to figure out a way to serve me while I'm small now," Mr. Cacciola said. "He knows he's got a good customer going forward."

**4. DON'T BE JUDGMENTAL**

Mr. Cacciola's adviser provides an annual presentation of how he is progressing toward his goals, but he doesn't give Mr. Cacciola too much flak when he falls short.

**5. BE AVAILABLE**

Mr. Cacciola's adviser sends an automated monthly email updating him on his investments, and also makes himself available for a call whenever Mr. Cacciola has a question or financial decision looming.

### OH HENRYS!

Priya Malani, founding partner of Stash Wealth, a firm dedicated to serving the High Earning, Not Rich Yet market (HENRYs), said millennials are ready to be taken seriously and are tired of being treated like D-level clients.

"We treat our clients like millionaires before they are millionaires," she said.

If firms really want to reach the next generation of investors, they must go beyond just rolling out a new app and website, said Bill Nelson, founder of Pacesetting Planning. He compares the moves many firms make to those of a local senior center just changing up the background music to become a hang-out spot for teens.

The solution entails more than technology. Working with millennials requires a different approach and business model.

"There's a stereotype out there that millennials care most about technology, and so you see larger financial planning firms rolling out apps and robo-advisers, and viewing this as sufficient to attract millennial clients," Mr. Nelson said. "But most of them still focus on retirement planning as their primary value-add; it doesn't work."

*rneal@investmentnews.com*
*Twitter: @ryanwneal*

# REFRAMING THE ROLE OF ALTERNATIVES

## Focus on investing for outcomes

Alternative investments can add value to portfolios, but their role remains misunderstood by many clients. New research from *InvestmentNews* and FS Investments explores the disconnects between advisors and investors when it comes to this asset class. Drawing upon surveys of both groups, the research paper reveals:

- Advisor and investor goals and their attitudes toward alternatives
- Ways to enhance advisor-client conversations around using alternatives to construct diversified portfolios
- Top drivers and hurdles to investing in alternatives
- The perceived benefits and drawbacks of alternatives
- Where advisors should turn for education on alternatives

KEY TAKEAWAY

**Reducing volatility is the primary driver of advisors' alternative investment usage**

Source: *InvestmentNews*/FS Investments survey, August 2019

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**$5.6M** AMOUNT FINRA ARBITRATORS ORDERED PERSHING TO PAY TO STANFORD PONZI VICTIMS.

# Schwab, Fidelity do battle over custody fees on RIAs

BY JEFF BENJAMIN

**KEY POINTS**

- Michael Kitces tweets spark chatter over new custody fees.
- Pricing convo involves RIAs that don't use Fidelity cash sweep account.

**SOCIAL MEDIA BUZZ** on Feb. 13 over custody fees at Fidelity Investments put the Boston-based giant on the defensive in the wake of a pledge from rival Charles Schwab Corp. to move seemingly in the opposite direction.

As Schwab touted a promise to roll out the red carpet, with no custody fee attached, for smaller registered investment advisers, tweets from social media maven Michael Kitces triggered chatter about Fidelity potentially layering on new custody fees for registered investment advisers that aren't sweeping client cash onto Fidelity's in-house platform.

Mr. Kitces, director of wealth management at Pinnacle Advisory Group, didn't mention Fidelity by name in his tweets, but did refer to a "not-Schwab" custodian reaching out to firms that are not profitable to Fidelity.

## FIDELITY RESPONDS

A Fidelity representative confirmed that conversations related to pricing take place on an ongoing basis.

"Fidelity is not introducing new fees; we have always offered clients a range of options and work with them collaboratively to identify the right pricing for the RIA," said Nicole Abbott, Fidelity spokeswoman.

"We encourage our RIA clients to focus on the total cost of ownership of a custody account," she added. "This includes the yield on cash sweep choices, commissions and other fees."

Although the timing of the social media chatter couldn't have been worse for Fidelity, this is not a new policy.

"Pricing discussions are a normal course of business for us, and we believe they are most meaningful when they are collaborative discussions," David Canter, head of Fidelity's RIA segment, said in a statement. "Fidelity has always taken a relationship-based pricing approach because this helps ensure that we are aligned with the needs of the firms we serve while also offering choice and the solutions that advisers need to deliver on their fiduciary responsibility," Mr. Canter continued.

Fidelity's response is in line with comments made by Mike Durbin, president of Fidelity Institutional, to Wealth Management in November, when he said a "not insignificant minority" of advisers who custody at Fidelity already operate under a fee-based model.

## FEE MODELS CALLED OUT

According to a Fidelity representative, the fee models paid by some advisers to custody on the platform can vary and are sometimes requested by the advisers who would rather pay some kind of fee or pass it along to clients than use Fidelity's cash sweep accounts.

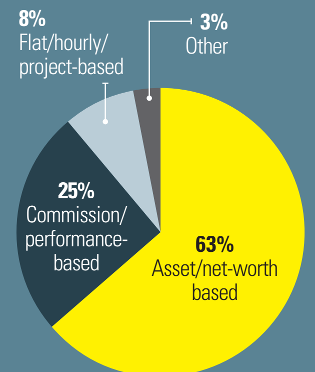
Mr. Kitces has highlighted and called out the "notable divergence when Fidelity is pushing out more custody fees and defending them as an industry practice, while Schwab just unequivocally pledged not to do so," but he also believes the industry will ultimately have to follow the direction of Fidelity.

"I believe that in the long run, the model will be a basis-point custody fee, and that for fee-only RIAs, they should ultimately want a fee-only custodian, which necessitates custody fees," he said.

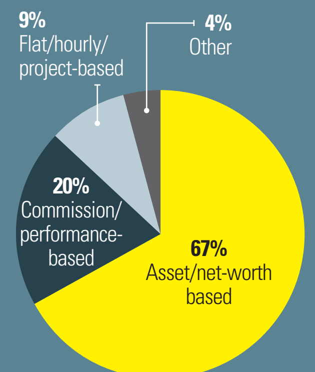
*jbenjamin@investmentnews.com*
*Twitter: @benjiwriter*

## IBD fees move to asset-based

Here is how advisers surveyed segment their revenue by type of fee, and what they project fee segmentation will look like in three years.




CURRENT FEE SEGMENTATION




PROJECTED SEGMENTATION – THREE YEARS

**Source:** *InvestmentNews* Research/State Street Global Advisors 2019 Elite RIA Study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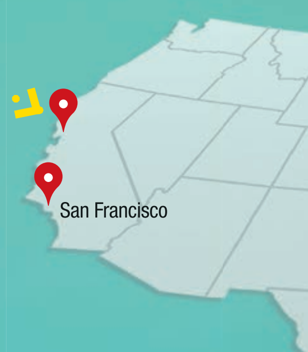


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# Annuity sales hit record in 2019 due to RILAs

BY EMILE HALLEZ

**VARIABLE ANNUITIES** had their best sales year since 2008 last year, powered by enormous growth in the sales of registered indexed-linked annuities, or RILAs.

Sales of those products, which have caps on investment returns and losses, were up 55% from 2018, according to a report last Tuesday from Limra's Secure Retirement Institute. Last year also set a record for overall U.S. annuity sales, at $241.7 billion, up 3% from $233.7 billion in 2018, according to the report.

That increase reflects strong sales during the first part of the year for fixed annuities and a distinct bump in variable annuities during the second half, said Todd Giesing, director of annuity research at the Secure Retirement Institute. That 2019 sales volume will be difficult to match in 2020, he said, particularly with the Securities and Exchange Commission's Regulation Best Interest going into effect in June, which could lead to some "turbulence" as insurers adjust their products and processes.

"We had a great start to the year in 2019, particularly on the fixed annuity side of the business," Mr. Giesing said.

**55%**
INCREASE IN SALES OF RILAs IN 2019 FROM A YEAR EARLIER

## STRONGER MARKET RETURNS

Fixed annuity sales hit $139.8 billion during 2019, up 5% from 2018, according to the Secure Retirement Institute. Fixed indexed annuities sales notched a record $73.5 billion, up 6% from 2018.

Demand for fixed annuities at the start of 2019 was driven by the stock market's drop in late 2018, Mr. Giesing said. However, low interest rates and stronger market returns shifted demand from fixed annuities to VAs. In particular, demand shifted from fixed indexed annuities to RILAs, he said.

Working in RILAs' favor is the fact that they have a higher cap on potential returns than FIAs, Mr. Giesing said.

Sales of RILAs, which are relatively new products, helped push VAs to their second consecutive year of increased sales. Since the financial crisis, VA sales have generally fallen, in part because of lower guaranteed benefits that carriers offer as riders on the products.

"The economic conditions are more favorable" for RILAs, Mr. Giesing said.

Sales of RILAs were $17.4 billion during 2019, which was more than 7% of all annuity sales last year and 17% of the total $101.9 billion in VA sales.

## MORE CARRIERS TO FOLLOW

Insurers have been adding more RILAs, and some are selling them with guaranteed living benefits, Mr. Giesing said. More carriers will likely add the products this year, he noted.

One company, Lincoln Financial Group, launched its RILA, Lincoln Level Advantage, in May 2018. Since then, the product has sold about $3.7 billion in contracts, including $2.7 billion during 2019. Last year, Lincoln Level Advantage accounted for nearly 20% of all annuity sales at the company and about a third of all its VA sales, said John Kennedy, head of Lincoln's retirement solutions distribution.

Although the product is available with the company's i4Life guaranteed living benefit rider, that option has accounted for a slim portion of sales, Mr. Kennedy said. "It's primarily been, for us, an accumulation product."

The company has made several changes to the product's features since its launch, he said. Last Tuesday, Lincoln added another option for new sales of B shares, which includes 10% downside protection for a three-year term.

Although stock market returns are a draw for VAs, the company's RILA product has sold well as investors have become leery of the bull market, he said.

*ehallez@investmentnews.com*
*Twitter: @EmileHallez*

# GPB Capital's legal woes mount with fresh lawsuit from Volkswagen

BY BRUCE KELLY

**GPB CAPITAL HOLDINGS,** which raised $1.5 billion from investors through the sale of high-commission, high-risk private placements, is involved in yet another legal dispute, this time with automobile giant Volkswagen over the control of auto dealerships that GPB has purchased.

Last Tuesday, Volkswagen of America Inc. filed an amended complaint against GPB Capital, alleging that GPB broke an agreement with Volkswagen in September when it removed David Rosenberg from his position as the head of three auto dealerships.

In July, Mr. Rosenberg sued GPB in Norfolk Superior court in Massachusetts, claiming the firm engaged in serious financial misconduct and that it tried to push him out after he complained to the Securities and Exchange Commission.

After Mr. Rosenberg was eventually pushed out, Volkswagen demanded that GPB divest from the dealerships, according to the new complaint. Last month, GPB moved for the matter to be moved to private arbitration.

## 'NUMBER OF FLAWS'

GPB tapped Mr. Rosenberg in late 2017 to operate its portfolio of motor vehicle dealerships, according to the complaint.

Volkswagen is seeking declaratory judgment in the dispute with GPB, which was filed in the U.S. District Court for the Southern District of New York, over the control of the three auto dealerships. Such a judgment would resolve the legal uncertainties for both sides of the claim with the court making a ruling on the matter.

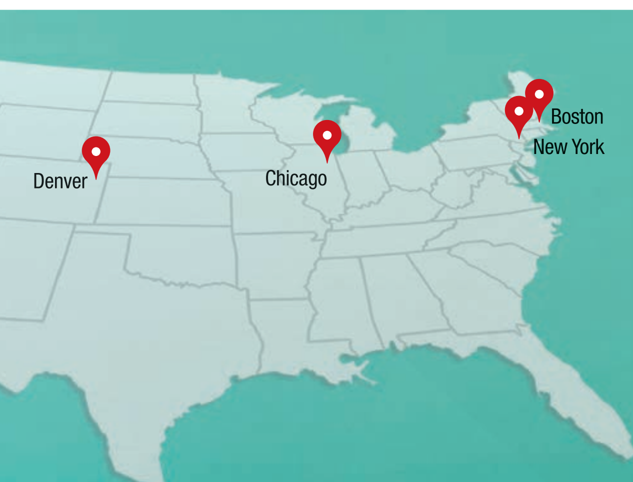
"Volkswagen of America has filed this suit to try to avoid arbitration sought by the dealerships," a spokeswoman for GPB, Nancy Sterling, wrote in an email. "This lawsuit has a number of flaws, and GPB will defend this vigorously."

GPB's stated business strategy was to partner with independent broker-dealers to sell private partnerships to wealthy investors. GPB was to use that capital to buy auto dealerships and waste management businesses, with the intent of generating high single-digit returns for clients. Such private placements usually generate steep commissions of 7% to 8% for brokers who sell the product, typically with additional fees and costs.

GPB Capital's legal problems are mounting quickly. It is under investigation by the FBI and the SEC and it has failed to produce audited financial statements for its funds. Investors don't know the value of the GPB funds, and thus, of their investments.

In October, the Department of Justice charged Michael Cohn, former chief compliance officer of GPB Capital Holdings and a former SEC examiner, with obstruction of justice relating to an SEC investigation of GPB.

*bkelly@investmentnews.com*
*Twitter: @bdnewsguy*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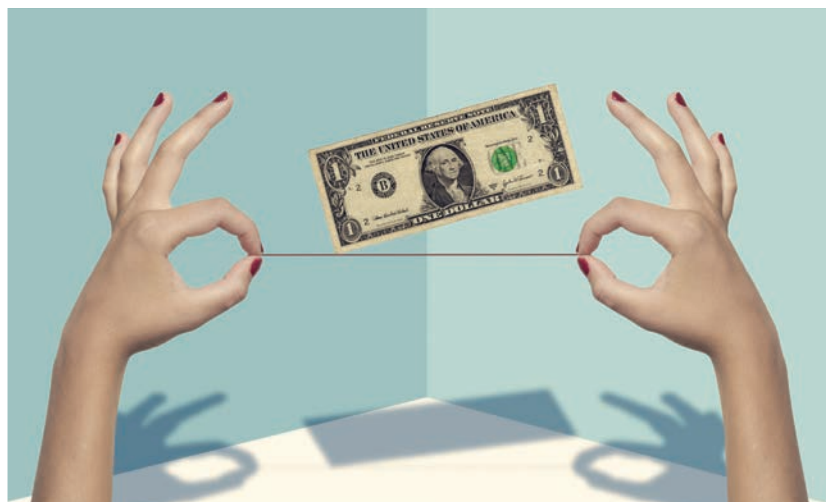

## A woman's guide to gaining financial security

MARY BETH FRANKLIN

ONRETIREMENT


It's February, and Americans have been bombarded with romantic images of hearts, flowers, chocolates and marriage proposals during the annual Valentine's Day advertising blitz. Less obvious is the short-term price tag — an estimated $27 billion spent on gifts — along with the long-term patterns that can tie love and money into a Gordian knot.

In her insightful new white paper, "Designing Your Economic Masterpiece In a Man's World," Meredith Moore, founder and CEO of Artisan Financial Strategies in Alpharetta, Ga., offers women a guide to money management and long-term financial security to combat centuries of cultural messaging that they are not suited to the task.

> **KEY POINTS**
> - Many women harbor fears of becoming a "bag lady."
> - Engaging in your own financial world enhances long-term financial security.

"For women of every age, income level and marital status, now is the time to adopt a proactive approach to learning about financial strategy," Ms. Moore said in releasing her new paper, which focuses on the intersection of gender, money and power, and the ways that gender role assumptions impact women's financial power within personal relationships.

"Women have made significant progress in entering the workforce over the past half-century, boosting our earning power higher than ever before," Ms. Moore wrote in the paper, which is based on the latest independent research on money and gender, as well as personal observations during her 20-plus years as a financial adviser. "With more income comes greater opportunity for building savings, but inadequate financial education and lack of confidence managing our own money continue to hold us back."

### DEEP-SEATED ANXIETY

Citing a Women, Money and Power Study from Allianz Life Insurance Co., Ms. Moore noted that 56% of single women and 55% of divorced women agreed with the statement: "Deep down, I worry about becoming a bag lady." Marital status is not solely responsible for the deep-seated anxiety. The same study found that 43% of married women and 48% of widows share the same sentiment.

Higher income doesn't guarantee financial confidence, either. More than one-quarter of survey respondents who earn $200,000 or more are still prone to bag lady fears.

Separately, a study published by the Center for Retirement Research at Boston College showed two-earner households losing more in post-retirement income than married couples with only one breadwinner, underscoring the fact that women of every marital status face a real possibility of experiencing financial need in their retirement years.

"Financial literacy is only one piece," Ms. Moore told me in a telephone interview. The bigger challenge is a lack of time.

"As breadwinner, caregivers, homemakers, cooks, community leaders, social liaisons, bookkeepers, chauffeurs and calendar coordinators, women have few free moments for self-care or additional learning that we once did," she wrote. "How do we get women, particularly those in senior leadership roles, to engage in a reasonable manner without killing their calendar?"

Simply becoming more engaged in the details of your own financial world is the first and most important thing you can do to prevent personal financial crisis, reduce financial risk and enhance long-term financial security, Ms. Moore said.

### TIME FOR EVALUATION

Start by evaluating the way your family handles household finances, whether through a whole wage system where one person manages all of the household finances; a pooling system, where a couples pool their money and treat it as a collective resource; an independent management system, where partners maintain individual control of their earnings; or somewhere in-between.

**Ask yourself:**

- Does this model create a balance of power that allows both partners to feel valued and heard?
- Does it provide adequately for household financial needs as well as personal spending by both partners?
- Does the model encourage secrets or dishonesty around finances?
- Does it feel fair to both partners in monetary terms as well as in terms of their ability to influence spending decisions?
- Does the model create risk for one partner in particular should the relationship end in death or divorce?

Regular financial discussions are a must for every couple, regardless of income or financial management style.

Similarly, meetings with the family's financial adviser should be viewed as can't miss events. If a woman doesn't want to participate in a meeting because the adviser ignores, discounts or treats her presence as an inconvenience, that's a clear indication that the couple needs a new adviser who will value her input.

"Marriage is a partnership that includes two people, whether that partnership is funded by one income or two," Ms. Moore said. "At the same time, you'll be preparing yourself to enjoy a comfortable financial future with your partner or to take the reins, financially speaking, should you ever need to."

**(Questions about new Social Security rules? Find the answers in my ebook at InvestmentNews.com/mbfebook.)**


*Mary Beth Franklin, a certified financial planner, is a contributing editor for* InvestmentNews.
*mbfranklin@investmentnews.com*
*Twitter: @mbfretirepro*


## Who wants to be a 401(k) millionaire?

Fidelity says average retirement account balances hit an all-time high in 2019, minting more million-dollar accounts.

**Source:** Fidelity Investments

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## Prioritizing college savings with clients

Morningstar recently issued its annual analyst ratings for college savings plans, upgrading eight plans and downgrading nine among the plans that represent 97% of assets invested in 529 plans. In California, where we administer the state's ScholarShare 529 college savings plan, the annual ratings prompt us to reflect on our plan and identify opportunities to help college savers maximize their college savings.

GUESTBLOG
JULIO MARTINEZ

While many advisers overlook college savings for a variety of reasons, our research suggests that prioritizing college savings represents an opportunity for advisers to grow their business. Clients with school-aged kids may be making mistakes without your guidance, and prioritizing college savings with your clients may be more important than you realize.

### GUIDANCE SOUGHT

Many clients aren't working with their advisers on college savings, which may be the reason many of them are making at least one critical savings mistake. In California, we asked 379 clients of financial advisers to share their views of college savings. The results suggest clients need your guidance:

- 44% are keeping their college savings in taxable accounts and paying avoidable taxes.
- 39% plan on using retirement savings to fund college expenses, which can significantly limit the potential for financial aid awards.
- 31% report losing sleep worrying about how their child will pay for college. These same clients say their adviser is not helping them tackle the college savings challenge.
- 70% said their adviser is not doing a great job on college savings.
- 76% are not counting on their adviser to help them reach their college savings goals.
- 65% don't consult with their adviser about college savings investments.

### 'STICKY' ASSETS

Helping your clients with college savings can provide several benefits to your practice. For example, college savings assets are traditionally "sticky" and long-term in nature. In California, nearly half of ScholarShare 529 beneficiaries are age 11 or younger, which means you may have a significant time horizon for managing college savings assets.

**39%**
CLIENTS WHO PLAN ON USING RETIREMENT SAVINGS TO FUND THEIR KIDS' COLLEGE

In addition, many 529 plans provide benefits and features that make it easy for you to help your clients save.

Many offer low-cost passive and active alternatives, and open-architecture investment options based on criteria that advisers rank highly. This limits the need for ongoing management with prepackaged portfolios.

In addition, 529 plans allow assets to grow free of state and federal taxes, which means your clients can potentially keep more of their returns by avoiding unnecessary taxes.

If you're not already prioritizing college savings conversations with your clients, there are several ways to begin doing so. First, start making college savings part of your discovery conversations with new clients and a discussion point in your annual check-ins with existing clients.

### MILESTONE EVENTS

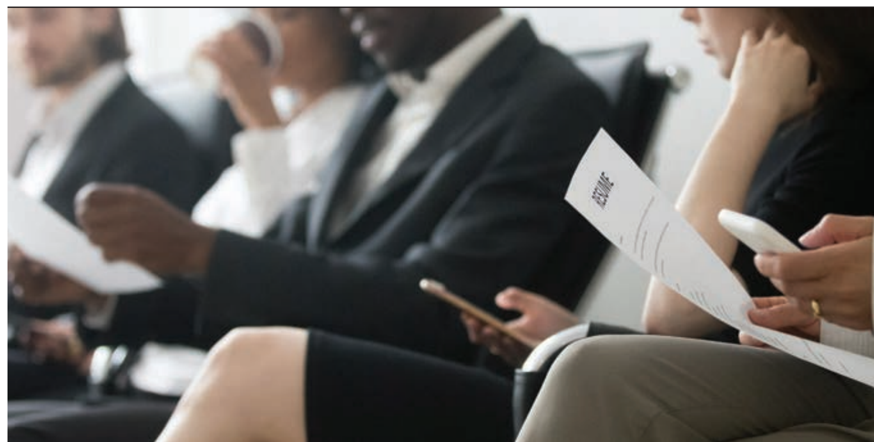
Using milestone events can open the conversations as well. For example, add 529 Day (May 29) and College Savings Month (September) to your calendar every year.

And when the holidays approach, consider suggesting that clients contribute extra funds to a loved one's 529 plan for the holiday season.

Finally, look for opportunities to engage multiple generations in college savings. Grandparents and other family members can contribute, and there are added estate planning benefits that come into play when multiple generations contribute.

Helping your clients maximize their college savings is an opportunity to showcase your value as a trusted adviser overseeing all aspects of their financial picture. Incorporating college savings into your practice can help you grow your business now and in the future.

*Julio Martinez is executive director of the ScholarShare Investment Board, which administers California's ScholarShare 529 college savings plan.*



## How advisers can attract top talent

Leading an independent wealth management practice for nearly two decades has taught me many lessons, but the most important is this: The quality of your employees determines the strength of your business.

The following are tips for helping financial advisers recruit top professionals who are ideal additions to their practices, based on my firm's experiences.

GUESTBLOG
KYLE BROWNLEE

**Interview and hire for alignment first, skills second.** An advisory practice's core values drive every part of the business. If a candidate doesn't understand the key underpinnings of a firm's culture and why team members do what they do on behalf of clients, then he or she won't be a good fit, no matter what skills or experience are found on their resume.

At my firm, we view our job as more than simply helping clients grow their financial resources — we work to craft financial plans that reflect the values they and their families live by and that enable them to use their wealth to do good in their communities. When interviewing candidates, we first make sure that they understand these vital elements of our culture and can share our commitment to clients (and each other).

**Broaden your outreach**. As every fisherman knows, fish won't bite if you lack attractive bait.

Advisers can market their practice as a good place to work by participating in or sponsoring regional "Best Places to Work" award programs. In order to attract bigger fish, you need to cast your net as widely as possible: Utilize social media platforms such as LinkedIn and Facebook, as well as job-search forums and relevant professional organizations, to advertise vacancies.

**Enlist existing team members in the search.** People who have already been well-assimilated into an advisory practice understand what qualities are necessary to succeed in their organization. If established employees know someone who shares the team's dedication and expertise, who would adjust smoothly to the firm's culture and job responsibilities, and who is seeking long-term employment somewhere they can grow, their input can be invaluable.

As an incentive for employees to become involved in the hiring process, advisory practices can provide referral bonuses. At my firm, we offer $1,000 for employees who steer us toward qualified friends and former colleagues who become new team members.

**Hire talent who can support your firm's (and clients') growth.** Don't discount job candidates because they have a specific skillset or experience you aren't looking for yet.

Some highly specialized areas of expertise, such as marketing, information technology, and human resources, can be extremely useful for helping an advisory practice perform better over the long term, and it can be wise to hire them proactively.

### UTILIZING EXPERTISE

Furthermore, their expertise can be utilized by clients who are business owners, which enhances our value as a professional partner. We allow clients to outsource marketing, IT, or human resources work to our employees — saving them time, preventing a pricey new hire, and allowing them to focus on what they do best. And, we generate revenue by billing for the outsourced work at an hourly rate.

Hiring mistakes are expensive. However, if you vet candidates for an understanding of your firm's core purpose, their potential contributions, and their ability to support future growth, you'll minimize the risk of attracting the wrong fit.

*Kyle Brownlee is CEO of Oklahoma City-based Wymer Brownlee Wealth Strategies and a registered representative with Avantax Investment Services.*

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**AMOUNT OF INVESTORS IN THE US THAT PLAN TO INCREASE THEIR USE OF ETFs IN 2020, UP FROM 59% IN 2019.**

**SOURCE:** BROWN BROTHERS HARRIMAN & CO. 7TH ANNUAL ETF INVESTOR SURVEY

# Financial advisers feel immune to economic risk of coronavirus

**BY JEFF BENJAMIN**

**EVEN AS THE** mysterious coronavirus has spread to more than three dozen countries, infecting nearly 77,000 people and killing more than 2,200 as of last Friday, financial advisers and their U.S. clients are mostly taking the lead of the stock market and essentially shrugging off the threat.

"I've gotten fewer inquiries about it than I was expecting, and most of the questions I've gotten were more about whether they should be traveling than about whether they should be adjusting their portfolios," said Michael Hennessy, founder and CEO of Harbor Crest Wealth Advisors.

"There will be an economic impact because the Chinese economy will have to slow down, and we already saw that in commodity prices, which are like the canary in the coal mine," Mr. Hennessy said. "But I tell my clients we're still long-term and we're not changing portfolios based on news coming out of China, because this month it's China, and before that it was Iran."

First discovered in mid-December in the city of Wuhan, the airborne virus so far has hit China the hardest. But the number of countries with infected citizens is rising, and medical experts have yet to identify a treatment or inoculation.

**KEY POINTS**

- Advisers have shrugged off threat of coronavirus on markets outside of China.
- China's economy represents 15% of global GDP.

### S&P RALLIES

Meanwhile, the S&P 500 Index, which experienced a brief 3% decline between Jan. 22 and Jan. 31, has since rallied by 4.2% and is up nearly 4% year to date.

"Clients are as nonconcerned about the coronavirus as they were about Iran a month ago," said Dennis Nolte, vice president at Seacoast Investment Services.

"The market did react to it, for about a day or two," Mr. Nolte said. "There's a reason Disney closed in Shanghai, and it might be one of the reasons [Shanghai's] stock market is not participating in the rally."

While the coronavirus continues to spread and inspire headlines, many Americans might be finding peace in comparing the virus to the flu in this country. For example, this year through Feb. 7, at least 19 million people in the U.S. had caught the flu, according to the Centers for Disease Control, which says the flu has already killed 10,000 people this season.

Commuters in Hong Kong MTR station

### 'WATCHING CAREFULLY'

Under the category of "better safe than sorry," Federal Reserve Chairman Jerome Powell said last Tuesday that it is too early to know whether the outbreak will affect central bank policy, but he stressed that, "We'll be watching this carefully."

The bond market, typically a step or two ahead of equity markets, is also paying close attention. Concerns over the virus are being cited as fuel for gains in bond ETFs that are driving down yields.

U.S. bond funds, which have experienced $21 billion worth of inflows this year, are likely benefiting from the bigger-picture perspective on China.

According to a Mercer report, China's economy, which is expected to be hit hard by the virus, represents 15% of global GDP, up from a 4% share of global GDP during the SARS epidemic in 2003. Severe acute respiratory syndrome infected 8,098 people worldwide and killed 774, according to the World Health Organization.

Against such a backdrop, many financial advisers are sticking with their long-term perspective or assuming the virus will not affect investment portfolios.

"For most clients, we wouldn't recommend taking any action within their portfolios specifically in response to the epidemic," said Steve Branton, an adviser at Private Ocean. "We don't believe it makes sense to alter a long-term strategy created in coordination with their financial plan in response to short-term market events."

*jbenjamin@investmentnews.com*
*Twitter: @benjiwriter*

# American Century to launch new ETF

**BY JEFF BENJAMIN**

**AMERICAN CENTURY** Investments, widely expected to make history in the coming weeks as the first asset manager to launch a nontransparent exchange-traded fund, filed a final registration statement on Feb. 10 and has gotten to the point where it is now able to discuss expense ratios, ticker symbols and other details.

"I don't see anything holding us up from launching before the end of the quarter, and American Century will be the first to launch one of these funds," said Ed Rosenberg, head of ETFs at American Century.

Of the dozens of funds from more than a dozen asset managers currently winding their way through the regulatory approval process, American Century's Focused Dynamic Growth (FDG) and Focused Large Cap Value (FLV) are considered to be well ahead of the pack and likely to be the first test of this unique type of ETF.

The result of a decade's worth of regulatory wrangling that has a half-dozen firms now licensed to offer various versions of the products, nontransparent ETFs are widely seen as a savior of actively managed mutual funds, which have been steadily losing assets to ETFs.

### GETTING ON BOARD

Nontransparent ETFs, which will be required to report their holdings quarterly, appeal to managers of actively managed mutual funds that have generally avoided launching active ETFs for fear of front-running, since traditional ETFs are required to report their holdings daily.

While the asset management industry is clearly behind the nontransparent movement, it is not yet clear whether financial advisers, the biggest users of ETFs, will get on board.

Two weeks ago, when advisers who custody at TD Ameritrade were asked whether they plan to allocate client assets to nontransparent ETFs, 92% said no.

Mr. Rosenberg recognizes that there will be some reluctance among advisers to jump headlong into a new and untested type of fund, but he believes the idea will grow on investors and advisers.

"You have those advisers who are looking for something unique in an ETF format and will invest right away, then there's a portion who will wait and see, and then you'll have a set that will never change because they only use indexes," he said.

The middle group is where Mr. Rosenberg hopes to win over converts, and he believes the expense ratios of between 42 basis points and 45 basis points on the American Century funds will be helpful in that effort.

"I think the middle set will come in at the six-to-eight-month window once they see what the fund is doing," he said.

**"I THINK THE MIDDLE SET WILL COME IN AT THE SIX- TO-EIGHT-MONTH WINDOW."**

ED ROSENBERG, HEAD OF ETFs AT AMERICAN CENTURY

American Century has a total of $183 billion under management, but just $1 billion in 10 ETFs, having entered the ETF space just two years ago.

Of the two nontransparent ETFs it is closest to launching, Focused Dynamic Growth, which will charge 45 basis points, is modeled on an American Century mutual fund with the same name, same management team and an 85-basis-point expense ratio.

Asked whether the new ETF is expected to cannibalize assets from the mutual fund, Mr. Rosenberg said the two different fund wrappers target different investor markets. "While there may be some people who switch, I would expect the majority of users to be new," he said.

*jbenjamin@investmentnews.com*
*Twitter: @benjiwriter*

# Franklin Resources agrees to buy Legg Mason in $4.5B deal

BLOOMBERG NEWS

**FRANKLIN RESOURCES** Inc. agreed to acquire asset manager Legg Mason Inc. for almost $4.5 billion in a deal that would create an active management investing giant.

Franklin will pay all cash for Legg Mason, the companies said in a statement last Tuesday. The transaction values Legg Mason at $50 per share, a 23% premium to the Baltimore-based company's share price on Feb. 14.

The transaction is another case of consolidation in the industry, as firms grapple with falling fees and the rising challenge from managers of index-tracking funds. In November, Charles Schwab Corp. agreed to buy TD Ameritrade Holding Corp. for about $26 billion; Janus Henderson Group and Standard Life Aberdeen were both formed in mergers in 2017.

### ACTIVIST STAKE

The announcement comes less than a year after activist investor Trian Fund Management took a 4.5% stake in Legg Mason, enough to secure its founder Nelson Peltz a position on the board.

Just days later, the fund manager said it would cut about 12% of its staff and reduce its executive committee to four members from eight. Mr. Peltz said at the time his three top priorities were "significantly reducing costs, driving revenue growth organically and through acquisition, and increasing profitability."

**$1.5T**

COMBINED FIRMS' ASSETS UNDER MANAGEMENT

The combined companies will have $1.5 trillion in assets under management. Franklin will also assume about $2 billion in Legg Mason debt.

"This is a landmark acquisition for our organization that unlocks substantial value and growth opportunities driven by greater scale, diversity and balance across investment strategies, distribution channels and geographies," Greg Johnson, executive chairman of the board of Franklin Resources, said in a statement.

Legg Mason closed down less than 1%, to $40.72, on Feb. 14, giving the company a market value of about $3.5 billion.

### PRESSURE BUILDS AS INVESTORS FLEE

Asset and wealth managers are facing unprecedented pressure on their bottom lines as investors increasingly pull money from actively managed funds and move them to cheaper passive ones that track benchmarks. The flood of money out of active and into passive funds has sent fees grinding lower, led to thousands of job cuts and forced large-scale consolidation.

Among other changes, Banco de Sabadell agreed in January to sell its asset-management business to Amundi for 430 million euros ($466 million), while GAM Holding considered a sale of the company last year. Last Monday, Jupiter Fund Management agreed to acquire rival U.K. asset manager Merian Global Investors.

Last Tuesday's announced deal is complementary because Legg Mason focuses primarily on retail investors, while Franklin Resources caters to institutional investors.


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# Regulation/Legislation

SEC / FINRA / STATE REGULATORS / CONGRESS / FIDUCIARY / COMPLIANCE

## Trade associations weigh in on advertising rule changes

BY MARK SCHOEFF JR.

**TRADE ASSOCIATIONS** representing investment advisers are grateful that the Securities and Exchange Commission is attempting to update adviser advertising rules for the first time since the Kennedy administration, but they're concerned that a recent proposal is too expansive and would raise compliance costs.

In November, the SEC released a rule proposal that would allow advisers to post testimonials, endorsements and third-party ratings on social media. It would also permit the use of investment performance results as long as the ads met certain requirements.

The proposal, which rewrites advertising rules for the first time since 1961, would define advertising as "any communication disseminated by any means" that is meant to increase an adviser's business. The previous rule applied only to written communications, TV and radio ads.

KAREN BAR

LAUREN SCHANDLE

GEOFFREY BROWN

### 'VERY CONCERNED'

The Investment Adviser Association was one of several trade groups that praised the SEC for drafting a "principles-based" rule that could evolve with communications technology.

But the IAA cautioned that the "expansive definition of advertisement" would require advisers to review almost all communications with clients.

"We are very concerned that the breadth of the definition of advertisement coupled with the onerous new review and pre-approval requirement under the proposed advertising rule would make the rule exceedingly difficult to implement and hamper investors' access to information they want and expect," Karen Barr, chief executive of the Investment Adviser Association, wrote in a Feb. 10 comment letter.

The comment deadline was Feb. 10, and the SEC received much input on the advertising proposal, which also included an update to requirements surrounding investment adviser payments to solicitors. The latter rules hadn't been revised since 1979.

The Financial Planning Association said that both the advertising and solicitation rules should be modernized but that the SEC is forcing a lot of compliance requirements on advisers all at once.

"It expands the scope of both rules by including additional forms of communication and different types of compensation, all of which will require a significant change to compliance procedures for advisers and solicitors," Lauren Schadle, FPA chief executive, wrote in a Feb. 10 comment letter. "FPA is concerned that the rule proposals would increase costs to all investment advisers' firms regardless of size."

> **"THE SEC OFFERS NO NEW RESEARCH … TO REFUTE THE BASIS FOR THE BAN."**
>
> KNUT ROSTAD, PRESIDENT, INSTITUTE FOR THE FIDUCIARY STANDARD

The National Association of Personal Financial Advisors expressed reservations about compliance costs. It also sent up a red flag about allowing advisers to pay for endorsements and testimonials, arguing that only large advisory firms could afford to finance advertising.

"We encourage the commission to promulgate final rules that minimize anticompetitive effects and unnecessary compliance burdens and costs for advisers who participate in the marketplace for personalized investment advisory services," NAPFA CEO Geoffrey Brown wrote in a Feb. 10 comment letter.

Mr. Brown also warned that paid endorsements would be "tainted by 'puffery' and personal bias" and would mislead investors.

Knut Rostad, president of the Institute for the Fiduciary Standard, said the SEC should reconsider lifting the prohibition on testimonials and endorsements.

"The SEC offers no new research or compelling analytical insights to refute the basis for the ban," Mr. Rostad wrote in a Feb. 10 comment letter. "Further, the SEC does not make a strong case that such advertising will help investors."

After reviewing the comment letters, the SEC could revise the advertising proposal or advance toward a final rule.

*mschoeff@investmentnews.com*
*Twitter: @markschoeff*

## Finra arbitrators award $2.1M to 4 former Credit Suisse reps

BY MARK SCHOEFF JR.

**FINRA ARBITRATORS** awarded $2.1 million to four former Credit Suisse registered representatives in a dispute involving deferred compensation.

In the Feb. 14 award, a three-person Financial Industry Regulatory Authority Inc. arbitration panel found Credit Suisse liable for a breach of contract involving Jonathan J. Galli, Paul T. Connolly, Alexander V. Martinelli and Christopher L. Herlihy.

The arbitrators awarded each of them compensatory damages, costs and attorneys' fees. They also awarded Mr. Herlihy interest on his damages. The total award was $2,096,609. The arbitrators denied Credit Suisse's counterclaim.

Three of the reps left Credit Suisse at the end of 2015 and the other departed in early 2016 after the firm shut down its brokerage business in the fall of 2015. At the time, Credit Suisse entered an exclusive agreement with Wells Fargo to recruit Credit Suisse registered representatives.

### COMPENSATION DISPUTE

Messrs. Galli, Connolly, Martinelli and Herlihy instead joined UBS. They alleged that Credit Suisse withheld deferred compensation that it owed them. Their case is one of several compensation disputes that have been brought against Credit Suisse by former brokers.

The key to the case was that arbitrators found the four brokers had their jobs eliminated by Credit Suisse and were eligible for the pay they say was withheld, said their attorney, Barry Lax, owner of Lax & Neville.

Credit Suisse indicated it will fight back. Company spokesman Jonathan Schwarzberg said a Finra arbitration panel last fall awarded the firm $9 million in damages and found that more than 100 of its reps left to join UBS as part of "an unlawful raid orchestrated by UBS."

"This recent case expressly reconfirms this obviously correct point that the claimants resigned and were not entitled to deferred compensation," Mr. Schwarzberg said. "Credit Suisse will vigorously defend any case that seeks unjust double compensation or otherwise seeks to paint individuals who 'hit the lottery' as victims."

Credit Suisse asserts that Finra arbitrators didn't expunge the reason for the claimants' departure on their records as evidence that they resigned to go to UBS.

Mr. Lax dismissed that assertion. "They didn't need to expunge the Form U5."

The former Credit Suisse brokers asked for about nine times more in damages than they received, but that didn't get Mr. Lax down.

"In these arbitrations, you tend not to get everything you ask for," he said. "In arbitration, a win is a win."

*mschoeff@investmentnews.com*
*Twitter: @markschoeff*

## MORGAN-ETRADE

CONTINUED FROM PAGE 3

the message was clear that negotiations were swift. "The more we looked at this, the more attractive it became," he said.

In response to a question about buying a discount brokerage platform instead of building one, Mr. Gorman said, "We didn't just buy a platform, there are millions of clients here. This takes us on a one-step leapfrog. We're not messing around."

### BUILDING A BEHEMOTH

In addition to its fledgling $20 billion RIA business, ETrade comes with 5.2 million client accounts and more than $360 billion in retail client assets. The deal, which is expected to close by the end of the year, will create a combined platform with $3.1 trillion in client assets, 8.2 million retail client relationships and accounts, and 4.6 million stock plan participants.

At first blush, the deal is being dubbed as more of the same in an industry seemingly drunk on consolidation.

"We see this as a continued validation of the financial services momentum toward greater consumer engagement, and ETrade brings that to Morgan Stanley," said H. Adam Holt, chief executive of Asset-Map.

Allan Katz, owner of Comprehensive Wealth Management Group, attributed the deal to fee compression.

"I think this is a further step in the race to zero in regard to fees," Mr. Katz said. "However, I also believe this is mainly cosmetic in the sense that nobody can operate for free. This will basically just give Morgan Stanley a way to market to people who are fee-adverse, and eventually try to switch them into accounts managed by financial advisers."

Meanwhile, the referral potential for independent advisers now working through ETrade could dry up under the deal, according to Michael Kitces, director of wealth management at Pinnacle Advisory Group.

"For advisers, significance is that ETrade will no longer have referrals for large firms? And may not even remain a custodial RIA platform for small firms, which either way, won't likely want to affiliate with Morgan Stanley-owned ETrade custody and its blatant channel conflict," he posted.

During the call with analysts, Mr. Gorman referred to ETrade's RIA business as "obviously interesting," but said that it "wasn't the primary motivator of the transaction."

But Ms. Bell of CFRA said that even if ETrade's RIA business wasn't the main attraction, it can serve as part of Morgan Stanley's efforts to expand its wealth management business.

"In this environment, bigger is better, and it's less risky to go out and buy someone," she said.

Morgan Stanley is also expected to capitalize on the 1.9 million stock purchase plan accounts that are serviced by ETrade.

"Right now, ETrade only gets about 10% of its customers' wallet share, but if this deal goes through there will be plenty of cross-selling opportunities," Ms. Bell said.

*jbenjamin@investmentnews.com*
*Twitter: @benjiwriter*

## CUE FROM MERRILL

CONTINUED FROM PAGE 3

Indeed, in its investor presentation about the deal, Morgan Stanley, which is buying ETrade for $13 billion in stock, noted that ETrade ranked among the top three self-directed brokerages, with 5.2 million client accounts and $360 billion in retail client assets. In a footnote to the presentation, Morgan Stanley noted that ETrade's peers include Fidelity, Charles Schwab and TD Ameritrade, which are currently working to complete a merger, and Merrill Edge.

Morgan Stanley's CEO, James Gorman, a former McKinsey & Co. senior partner, was in charge of Merrill's brokerage business before jumping to Morgan in 2006, so he clearly understands his competition.

For years, the large wirehouses have been pushing brokers to stop working with less-profitable clients, or those with assets less than $250,000 to $500,000. But through platforms like ETrade or Merrill Edge, those clients still have a home at a full-service brokerage, one recruiter noted.

"The industry has realized it's profitable to service these smaller relationships," said Louis Diamond, vice president and senior consultant at Diamond Consultants, an industry recruiter.

Merrill Edge has also proven to be a training ground for younger financial advisers, noted another recruiter, Danny Sarch, of Leitner Sarch. In the spring, Merrill said it was hiring 300 young advisers, many of whom had experience working with Merrill Edge.

"Will ETrade be a place to prepare young advisers for Morgan Stanley?" Mr. Sarch asked.

*bkelly@investmentnews.com*
*Twitter: @bdnewsguy*

## MASSACHUSETTS

CONTINUED FROM PAGE 2

will create a patchwork of regulations that will make compliance difficult and costly. The industry favors Reg BI as the only advice standard.

The final Massachusetts rule has been modified from the original proposal in ways that address some industry concerns.

Debra O'Malley, a spokeswoman for Mr. Galvin, said the final rule will not apply to insurance sales professionals and won't impose an ongoing fiduciary duty on brokers unless account monitoring is part of the customer contract.

The final rule also doesn't include adviser title restrictions and it doesn't apply to investment advisers, who are already held to a fiduciary standard. It also no longer governs municipal bond sales, Ms. O'Malley said.

The financial industry has indicated that it is considering filing lawsuits against state investment-advice rules.

"If a lawsuit happens, we'll address it at that time," Ms. O'Malley said.

*mschoeff@investmentnews.com*
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## FED REVIEW HURDLE

CONTINUED FROM PAGE 3

strictness has not been the norm among financial regulators, especially in recent years. Such a big deal is hardly happening without at least an implicit acquiescence or at least knowledge of the key regulators."

Ms. Omarova added: "Politically, the company's emphasis on expanding its gold-standard Wall Street asset management services to regular folks probably makes this merger more difficult to attack head-on. This deal lacks an intuitively graspable political salience that usually prompts a strong political reaction."

Nonetheless, the Morgan Stanley-ETrade tie-up generated push back on Thursday from a liberal financial services organization.

### BIGGER THAN 'TOO BIG'

"The last thing that our economy needs is for one of the 'Too Big to Fail' banks to get even bigger," Graham Steele, a senior fellow at the American Economic Liberties Project, said in a statement. "This deal would allow one of Wall Street's biggest banks to accumulate even more market power, giving it more control over working people's retirement savings and deposits, and putting the public on the hook for even more potential risks. Any public official that is truly concerned about preserving competitive markets and preventing taxpayer bailouts must oppose this acquisition."

But that kind of political opposition from an interest group may not gain traction in the Capitol.

"I don't think anybody is worried this is going to give Morgan Stanley monopoly pricing power in the retail market," said Tyler Gellasch, executive director of Healthy Markets, an investor trade group.

Mr. Gellasch, a former counsel at the Securities and Exchange Commission and a former Senate aide, said the lack of objections in Washington to Charles Schwab Corp.'s acquisition of TD Ameritrade is instructive when it comes to Morgan Stanley taking over ETrade.

"I thought Schwab buying TD Ameritrade would raise more concerns with regulators and policymakers," he said. "I would expect even less resistance for this acquisition."

**"I THOUGHT SCHWAB BUYING TD AMERITRADE WOULD RAISE MORE CONCERNS."**

TYLER GELLASCH, EXECUTIVE DIRECTOR, HEALTHY MARKETS

Morgan Stanley's swallowing up ETrade could be viewed two ways in terms of its impact on the Schwab-TD deal. On the one hand, it effectively removes ETrade as an independent competitor for servicing registered investment advisers.

But Mr. Seiberg says it could ensure approval for the Schwab-TDA deal.

"This might help Schwab's acquisition of TD Ameritrade as a Morgan Stanley-backed ETrade may be seen as a stronger potential competitor," he wrote. "It is worth watching if Morgan Stanley discusses plans for the custodial business for registered investment advisers, which we see as the key issue for Schwab."

*mschoeff@investmentnews.com*
*Twitter: @markschoeff*

## RUDY ADOLF

CONTINUED FROM PAGE 3

Stanley acquisition on a call with analysts to discuss Focus Financial's earnings, Mr. Adolf took a swipe at retail brokerage.

"It's simply a reflection that the traditional [brokerage] model is broken and cannot compete with the winning model in this industry, which is the RIA/fiduciary model," he said.

The RIA side of the financial advice business "of course is gaining market share to the tune of hundreds of billions of dollars [in client assets] per year," Mr. Adolf said. "This means when you're operating on the losing side of the equation, you need to do consolidation."

**$1.2B**

TOTAL REVENUES POSTED BY FOCUS FINANCIAL LAST YEAR

### DEFENSIVE MOVES

Morgan Stanley's purchase of ETrade and Charles Schwab's deal to acquire TD Ameritrade are defensive moves, Mr. Adolf said. Such deals are "traditional consolidation moves that are ultimately defensive in nature and not about [adding] higher client value but really about cost savings and consolidation."

Of course, senior management at Morgan Stanley clearly disagrees with Mr. Adolf.

"ETrade represents an extraordinary growth opportunity for our wealth management business and a leap forward in our wealth management strategy," Morgan Stanley's CEO James Gorman noted in a statement. "The combination adds an iconic brand in the direct-to-consumer channel to our leading adviser-driven model, while also creating a premier workplace wealth provider for corporations and their employees."

Meanwhile, Focus Financial posted total revenues of $1.2 billion last year, an increase of 33.8% when compared to a year earlier. It also reported a loss of close to $12.9 million.

*bkelly@investmentnews.com*
*Twitter: @bdnewsguy*

## T3 CONFERENCE

CONTINUED FROM PAGE 2

T3 2020 was a more subdued affair.

When asking around the conference, I heard several suggestions from attendees on why things felt different this time, though none were willing to go on the record.

One idea was the rise of new competition. Until a few years ago, T3 was the only adviser tech conference around. Today, technology is a prominent feature at nearly every firm's conference, and most of the large vendors have their own. There's also

**"WHAT PERCENTAGE OF ATTENDEES ARE ACTUALLY ADVISERS?"**

ALEX CHALEKIAN, HEAD OF PRACTICE ACQUISITIONS, INTEGRATED PARTNERS

the new WealthStack event, which bills itself as an adviser technology conference and which was criticized over the fall by industry blogger Bob Veres, who partners with T3 founder Joel Bruckenstein on the annual T3 Tech Survey.

### ATTENDANCE CHALLENGED

Others feel there simply aren't enough advisers at the T3 conference. In private conversations, technology vendors asked if I had met any advisers, and the advisers I met wondered if they were alone. Integrated Partners head of practice acquisitions Alex Chalekian took the question to Twitter.

"A number of my friends are at the T3 Advisor Conference, which is meant for advisers. I'm genuinely curious, what percentage of attendees are actually advisers?" Mr. Chalekian tweeted. Of those who responded, 33% voted less than 10%.

Mr. Bruckenstein acknowledged that the demographics of the conference have changed. T3 launched 17 years ago to bring advisers together and connect them with technology leaders rather than salespeople. Though the overall adviser count grew to 350 this year, so did the number of technology vendors, private equity firms and industry consultants. Now advisers account for roughly half of the overall attendees.

Michael Kitces, director of wealth management at Pinnacle Advisory Group, said on Twitter that while T3 features "a heavy component of vendors, not 'just' advisers," he still views it as a valuable event for most vendors.

"There are enough advisers there that the economics are still worthwhile for most vendors. Think of it this way, you buy a booth to reach 300 advisers — does it matter if there are also 300 vendors? Or 600? Or 1,200? 80% vendor there is still 300 advisers for booth ROI," he tweeted.

### NO COMPETITION

Mr. Bruckenstein doesn't agree that there is growing competition in the fintech conference space, saying that no other gathering features an array of technology firms as rich and diverse as T3.

"There is only one time in the whole year where everybody who matters in adviser technology is under one roof, and that's now," he said.

Mr. Bruckenstein also disagreed that T3 was slower this year than in previous years, arguing the nature of the announcements has changed because of the market.

"I think today in particular, because of the nature of what's going on with the M&A, a lot of this stuff is time-sensitive," he said. "Whereas before, people might have waited an extra couple of weeks or a month to make an announcement at T3, now they're on shorter timetables and they just want to get this stuff done as soon as possible."

What's most important to him is the launches of new products like Summit or Andrew Altfest's FP Alpha financial planning software, and big announcements from firms like Envestnet MoneyGuide and Orion Advisor Services.

Envestnet MoneyGuide added to its Blocks feature, which lets clients create small pieces of a financial plan at a time and revealed new tax planning optimization and API access for third-party developers. Orion Advisor Services launched a completely new user interface, which is no small undertaking for such a large and popular adviser fintech.

"Those are major, major, major announcements," Mr. Bruckenstein said.

Overall, he said that he has no immediate plans to change anything about T3.

"At some point I'll either get tired of it or I'll find a partner or find a transition, but hey, I love this," Mr. Bruckenstein said. "If it's fun, it's not work. There's nothing I enjoy more than doing this."

*rneal@investmentnews.com*
*Twitter: @ryanwneal*

# WOMEN to WATCH

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