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The Web Effect: Reinventing the Financial Services Industry and Its Pricing By Democratizing Access

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With stockbrokers, financial planners and insurance agents all maintaining that they are acting in the client's best interest in providing the highest level of counsel, it has long been terribly confusing for investors to determine who, indeed, is acting in their best interests. Thankfully, we have finally reached the tipping point in the financial services industry's evolution where the consumer will actually be able to discern high level counsel.

In order to ensure the faith and trust placed in the financial advisor to act in the investor's best interests, the SEC will require that by early October 2004 the financial advisor have a code of ethics that acknowledges their fiduciary status. Though financial advisors with major brokerage firms are exempt from having to declare their fiduciary status, registered investment advisors (RIA's) with the SEC will not be shy in making it clear to the investor that there is a much higher level of counsel, accountability and professional obligation in their fulfilling their fiduciary responsibility than advisors simply posing investment alternatives and requiring investors to exercise their own limited judgment on investment merit. But as the adage goes, "beware of what you pray for, as you may get it."

OUR INDUSTRY'S MOST ACCOMPLISHED ADVISORS HAVE LONG HOPED THAT PROFESSIONAL INVESTMENT AND ADMINISTRATIVE COUNSEL WOULD EVENTUALLY EMERGE AS A PROFESSION WITH EQUAL FIDUCIARY STATUS AS OTHER PROFESSIONS ENTAILING TRUST

Our industry's most accomplished advisors have long hoped that professional investment and administrative counsel would eventually emerge as a profession with equal fiduciary status as other professions entailing trust. And now that the professional standing of each advisor will be clearly declared, certainly all advisors – RIA's, commission brokers, financial planners or insurance agents, etc. – will want to "act in their clients best interests in fulfilling their fiduciary obligations." Yet, the fiduciary responsibility of the advisor is not a condition of membership of any major industry trade association nor is it acknowledged by any major financial services firm that supports financial advisors. So, how does the advisor fulfill their fiduciary responsibilities? Where does the financial advisor go for support? Their supporting brokerage firm does not offer the processes, technology and infrastructure to support the fulfillment of fiduciary responsibility, nor are our industry's leading trade associations familiar with what is required for their constituents to act in a fiduciary capacity. The entire historical concept of financial product promotion and distribution and commission sales being literally synonymous with the financial services industry (you don't get paid until you sell something) is changing and is now out of synch with the new reality of the marketplace tied to the fulfillment of fiduciary responsibility. Every investor wants their advisor to act in their best interest in addressing and managing the full range of investment and administrative values necessary in order for the adviser to fulfill their fiduciary obligations and responsibilities. Yet, the financial services industry has done everything within its power to insulate itself from fiduciary responsibility, rather than embrace and support it. Who would argue with the point of advisors acting in their clients' best interests? Our free enterprise system is based on the merit of ideas. Today, the web transcends the structure and culture of the industry that impedes innovation by democratizing access to the processes, technology and infrastructure essential to adding value, fulfilling fiduciary responsibility and providing continuous, comprehensive counsel as

required by regulatory mandate. Direct access to web-based processes, technology and support infrastructure is essential to the elevation of the role and counsel of the financial advisor and their professional standing. The inability of our industry's leading financial services firms and trade associations to support the fiduciary status of financial advisors will foster the reinvention of the financial services industry and will certainly reprice the services, changing the relationship of the advisor with their supporting brokerage firms. The advisor is now being held accountable to a fiduciary status, and all clients want their advisor to act in their best interests. Yet little, if any, of the necessary support infrastructure to fulfill fiduciary responsibility is being provided for the advisor. This puts the advisor in an untenable position and, as Benjamin Franklin said, necessity is the mother of invention.

This summer, SrConsultant.com will begin publishing in its Consultant's Toolbox market research/evaluations/competitive rankings of web-based resources for each element of the enabling processes, technologies and infrastructure (see "Enabling Technology and Infrastructure," *Senior Consultant,* Nov. 2003, http://www.Sr Consultant.com/Articles/2003-11-Enabling-Technology.pdf) essential for the advisor to fulfill their fiduciary responsibilities. The idea in creating access and transparency is to make advisors aware of all their web-based resource alternatives to foster further innovation and adoption. For example, in investment policy, the Consultant's Toolbox will provide a comparative analysis of all web-based investment policy vendors, their pricing, functionality, operational support, training, user group organization, references, strengths and weaknesses. By creating transparency and access, SrConsultant.com will accelerate the learning curve of advisors and the industry, and foster further innovation and the early adoption of enabling processes, technology and infrastructure necessary for advisors to serve in a fiduciary capacity. The advisor is empowered, independent of the cultural limitations and constraints of their supporting brokerage firm, to be outstanding. Thus, account executive excellence becomes a matter of choice. This is free enterprise at its best, serving the common good of the investing public.

Hopefully, all advisor support organizations will adapt their culture, structure and technology to become early adopters as well, as their ability to command their present pricing for the limited services they do provide will erode very quickly. Today, it is possible for the average advisor at a major warehouse with $50 million under advisement to take the 70 basis points they pay their firm to participate in their wrap fee programs (where it is not possible to add value due to their very narrow investment focus) and redeploy that $350,000 within their practice to hire a chief administrative officer and a chief investment officer, and bring all the enabling technology in-house to create a far superior value proposition (legitimate investment policy, the incorporation of all the client's holdings so it is possible to add value with continuous, comprehensive counsel, etc.) that is pre-emptive to the counsel engendered by their supporting firm (see "How Are Top Advisors Growing Their Business in a Difficult Environment?" *Senior Consultant,* April 2003, http://www.SrConsultant.com/Articles/2003-04-Top-Advisors-Grow.pdf).

THE ADVISOR IS EMPOWERED, INDEPENDENT OF THE CULTURAL LIMITATIONS AND CONSTRAINTS OF THEIR SUPPORTING BROKERAGE FIRM, TO BE OUTSTANDING

Because commission sales is the dominant culture of the financial services industry, we often forget if an advisor is not selling financial products but is addressing and managing values, they don't have to be licensed with the NASD to sell securities, they just have to be registered as an investment advisor (RIA) with the SEC in engaging their professional investment and administrative counsel for an on-going advisory fee. The RIA does not even necessarily need the support of a traditional brokerage firm geared to product promotion and distribution. Schwab Institutional, which is built around supporting RIA's, is not a brokerage firm because its advisors do not take commissions, they engage their counsel for a fee. Interestingly, several electronic crossing networks (ECN's) are considering offering unlimited product access, custody, trade execution, clearing and reporting to advisors with at least $100 million under advisement for five basis points, or $50,000, in an effort to compete with Schwab. Given one is only worth its replacement cost, this pricing would clearly shift the balance of power to the financial advisor. The inability of our industry's leading institutions to acknowledge and empower the financial advisor to fulfill their fiduciary obligations will greatly limit their role, eroding their value and ability to price their limited services. The financial advisor is increasingly in control of their value proposition and their clients, and is emerging as the primary driver of the industry, not their supporting firm's vision of minimizing the role and counsel and the fiduciary liability of their advisors. What is in the best interest of the advisor support organization – which minimizes the fiduciary liability of its advisors – is in conflict with the advisor acting in their clients' best interests and fulfilling their fiduciary obligations. The advisor support organizations that will flourish are those who treat the advisor as a highly valued, highly skilled constituent who put their clients' interests first, rather than an employee with little or no influence on what resources are made available. It is important to note in today's regulatory environment, there is far more liability in an advisor support organization not supporting the fiduciary responsibility of their advisors than in supporting them.

Just as the web has democratized direct client access to financial products, trade execution and institutional pricing which, in turn, has driven down cost and facilitated account transparency, the only thing that will not become a commodity is the professional investment and administrative counsel of the advisor, and faith and trust they inspire.

The Consultant's Toolbox will not only provide objective market research/evaluation/ranking of enabling processes, technology and support infrastructure essential to the advisor's fulfillment of their fiduciary responsibility, but will provide the advisor direct access to those vendors on the basis of very favorable pricing. In the months ahead, SrConsultant.com will democratize the intellectual property associated with adding value and provide access to the processes and technology necessary for advisors to fulfill their fiduciary obligations. Where there are holes in the enabling processes and technology, your discernment as advisors and the free enterprise nature of the web should stimulate immediate responsiveness by vendors focusing on creating a critical mass of early adopters. Thus, you will play an active role in stimulating innovation and the natural evolution of process and technology. Your responsiveness and interaction with vendors is the "why" and the "how" of the web reinventing the financial services industry and empowering the financial advisor.

From the very start, the focus of the Consultant's Toolbox will be to reduce the labor intensity of advice while empowering the financial advisor to fulfill their fiduciary obligations. The initial focus will first be on the areas of greatest impact: the investment policy statement. The ability to create investment policy statements for each of the ten major market segments of the individual (mass, retail, high net worth and ultra high net worth) and institutional (defined contribution, defined benefit, public funds, profit sharing, foundations and endowments and Taft Harley) investor markets will be one of the first research and development projects. Core web-based portfolio management technology (subaccounting, trade and order routing, and reporting) to include Advent and Centerpiece, will be evaluated relative to new, more robust, less expensive institutional applications such as Integrated Decision Systems, Eagle and Informa, which are now within the reach of the individual financial advisor. There will also be research on the division of labor in larger, more successful practices, with accompanying job descriptions which will outline responsibilities and skill sets, delineating those within the practice who manage systems and administration (COO), portfolios (CIO), and the enterprise (CEO). There will be research on best practices in post-Modern Portfolio Theory processes and technologies used to construct portfolios and a comparative explanation delineating breakthrough innovations in post-Modern Portfolio Theory and the associated tools necessary for the advisor to gain access to those innovations. There will be research on trade execution, best execution and beyond best execution. Essentially, the Consultant's Toolbox will outline the processes, technologies and infrastructure necessary for the advisor to excel in the engagement of their counsel and the fulfillment of their fiduciary obligations.

The financial services industry is undergoing a metamorphosis, where the role and the counsel of the financial advisor is being greatly elevated, as is the advisor's professional standing. Product access, trade execution and facilities management alone can no longer command 60% or more of the advisor's gross revenues, especially since everything but facilities management can be obtained for five basis points or less. Inexpensive access via the web to processes, technologies and resources not available in commission sales organizations but essential to adding value and fulfilling fiduciary responsibility, will change how the financial services industry does business. Much like other professions entailing trust, the financial advisor will be held to a fiduciary standard, with the expectation they will always act in the investors' best interests. But because of the confusion in the roles that financial advisors can play in the financial services industry, a disclosure documentation is required to clarify and evidence fiduciary standing. Our free enterprise system is built upon the merit of ideas and ideals. The web democratizes ideas so that they transcend organizational structure and culture, making it possible for the financial advisor to not only do the right thing but to continually elevate their counsel through immediate access to breakthrough innovation. In an industry that will not acknowledge the fiduciary responsibility of its advisors, we are about to see an unprecedented level of professional investment and administrative counsel unfold, where every advisor can be both enabled and capable of addressing the full range of investment and administrative values required by regulatory mandate. This is the reinvention and repricing of the financial services industry, made possible by the web, which elevates the industry, the advisor and their counsel. ■

Notes

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