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SENIOR CONSULTANT
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Enabling Technology That Brings Fiduciary Counsel Within The Reach Of All Advisors

by Stephen C. Winks

Every investor wants their advisor to act in their best interests so they can trust and rely upon their advisor's counsel. Unfortunately it has not been clear to the consumer that it is a violation of the internal compliance protocol of NASD member brokerage firms for a broker to acknowledge their fiduciary obligations to their clients. Brokers cannot even acknowledge they render advice. Consumers have unknowingly been put in a situation where they have had to be their own counsel in determining investment merit, regardless of how limited their investment knowledge and experience may have been. In an effort to protect the trust of the investing public, the SEC now requires a disclosure statement of all advisors who cannot declare they are acting in a fiduciary capacity. The disclosure statement in short requires the advisor to state in writing "I am acting in a sales capacity and am not obligated to act in your best interests." Given the trust every investor vests in their advisor, every investor will demand their advisor to fulfill their fiduciary responsibilities and act in their best interests. This is a challenge for the brokerage industry. The brokerage industry has lobbied very hard to avoid their advisors being held to a fiduciary standard of care. The industry has no intention of supporting their advisors in providing fiduciary counsel; otherwise there would be no need for a disclosure statement. Thus every advisor in the industry is on their own when it comes to fulfilling their fiduciary responsibilities. Every advisor in the industry is asking the question, "How do I automatically manage an extraordinary degree of account detail as cited in investment policy, dictated by client directive and required by regulatory mandate for an unlimited number of custom accounts, on a fully transparent basis at the lowest possible cost, while out performing the market, all within a fiduciary construct?" In this research report you will see all this is possible and is within the reach of most advisors, you just need a little help.

Fiduciary counsel sounds like a different business than commission sales, and it is. We all were hoping, with the new disclosure statement, that the industry's leading firms would voluntarily build a prudent process, a conflict free business environment and the enabling resources necessary to support fiduciary counsel. Instead, Wall Street has fought the acknowledgement of their advisor's fiduciary responsibilities and actually lobbied for the disclosure statement, which is such a disservice to the 658,000 licensed advisors with in NASD member brokerage firms. It is clear to everyone, that unless you are committed, you will never excel at fulfilling your fiduciary obligations. Can you imagine an athlete who aspires to high professional standing, not being committed to their sport? To this day within major NASD member brokerage firms, it is no possible for middle management to even advocate support for advisors to fulfill their fiduciary responsibilities. Thus, NASD member brokerage firms have crippled them selves thwarting the emergence of an infrastructure in support for fiduciary counsel. With the new disclosure statement effective January 31st, the consumer can easily see who is acting in their best interests and fulfilling their fiduciary responsibilities. Industry leadership has been reordered. Rather than looking to Wall Street for leadership, we are looking to independent RIAs. These are the RIAs, who based on principle, have relinquished their brokerage licenses in order to work in a conflict free environment, so they can act in their client's best interests and fulfill their fiduciary responsibilities. There are no cultural obstacles inhibiting RIAs from acting in their clients best interests, while the broker cannot, as it is a violation of the internal compliance protocol of their NASD member brokerage firm for them to even acknowledge they render advice.

> **CONSUMERS HAVE UNKNOWINGLY PUT THEMSELVES IN A POSITION WHERE THEY ARE THEIR OWN COUNSEL IN DETERMINING INVESTMENT MERIT, REGARDLESS OF THEIR INVESTMENT KNOWLEDGE AND EXPERIENCE.**

In principle and in practice the RIA has a preemptive value proposition. For less money than the broker is now paying to participate in their firm's wrap fee program, the RIA can hire their own staff, bring their technology in-house and create a preemptive, predatory value proposition, capable of being held to a fiduciary standard of care, not possible within a NASD member brokerage firm. Today, thanks to technological advances, fiduciary counsel is within the reach of the individual advisor and it is far less expensive to support than commission sales, where by definition it is not possible to add value in a series of disjointed unrelated transactions. Since the invisible hand of the free markets envisioned by Adam Smith in 1776, technological innovation and the free markets have invariably arrived at the perfect faster, better, cheaper solution. Fiduciary counsel is no different. Once fiduciary counsel is within the reach of the advisor, the debate of whether advisors can declare their fiduciary status, or not, becomes moot, as it now becomes the advisors choice not their supporting firm's. The free markets take care of the rest: the consumer clearly prefers the advisor to act in their best interests and fulfill their fiduciary obligations. Until Wall Street reconciles its obligation to support its advisors in fulfilling their fiduciary responsibilities, its clients and its advisors will be attracted to a faster, better, cheaper solution of fiduciary counsel offered outside a NASD member firm construct.

> UNLESS THE INDUSTRY IS COMMITTED TO FIDUCIARY COUNSEL IT WILL NEVER EXCEL, CAN YOU IMAGINE AN ATHLETE WHO ASPIRES TO HIGH PROFESSIONAL STANDING, NOT BEING COMMITTED TO THEIR SPORT?

There is ample evidence that the consumer prefers "fiduciary counsel" of the RIA to "objective advice" or "wealth management" of the commission broker. The consumer can see the fallacy of the broker providing objective advice, if the broker is not acting in their best interests. A case in point is the 3,000 RIAs in Schwab Institutional, who have given up their brokerage licenses and have more than $100 million each under advisement. Last year Schwab Institutional garnered $44 billion in net new assets, relative to Merrill Lynch's 15,000 advisors garnering $10 billion. Schwab's 3,000 RIAs garnered more net new assts than all the major wirehouses combined with their 60,000 advisors. The marketplace is sending a clear message: the consumer finds a conflict free working environment and the advisor's acknowledgement of their fiduciary responsibilities very appealing. Just as industry assets over the past decade have evolved from banks to brokerage firms, now over next decade assets will evolve from brokerage firms to RIAs, who are the faster, better, cheaper solution.

So, How Do You Fulfill Your Fiduciary Obligations?

Don't worry if your strengths are not in technology or process or if you don't know where to start. The Society of Fiduciary Advisors (SFA) can help you with materials just like this research report, outlining how you can fulfill your fiduciary obligations. By putting research like this in the public domain the SFA hopes to bring fiduciary counsel within the reach of all. In the next few pages the SFA establishes a process and technology model that you can replicate as an individual advisor, that will allow you to fulfill your fiduciary obligations at less cost than you are now paying to participate in your firm's wrap fee program. The SFA can also be helpful in putting you in touch with service bureaus, vendors and technical experts who will help you create your own prudent investment process and support infrastructure. This will allow you to drive down your cost well below the sixty percent plus of gross revenues that the major wirehouses require of you, while you create a preemptive and predatory value proposition. By not being limited by the cultural constraints of NASD member firms, you have the license to streamline conventional industry support around a prudent investment process, which can be audited back to statute, case law, regulatory opinion letters and best practices, definitively assuring your clients you are fulfilling your fiduciary responsibilities. You will be cutting out all cost that adds no value, gaining a cost and pricing advantage. You will be taking control of your investment process, enhancing your ability to manage an extraordinary degree of portfolio detail necessary to fulfill your fiduciary obligations. You will gain access to investment methodologies, which will out-perform relative to the custom performance benchmarks for each of your client's portfolios. You will be offering continuous comprehensive counsel necessary to fulfill your fiduciary obligations. Because you are ever vigilant of the investor's best interests and because you are adding value, you literally become the value added. By maximizing the your value proposition, you also maximize your compensation and the value of your practice. If we focus on a fiduciary construct that has the investor's best interests in mind, directed by the advisor, with no extenuating cultural or political considerations that would compromise the best interests of the consumer or advisor— the industry is taken into an entirely different direction than today's commission sales business model.

If we remove the cultural and structural burdens that entail significant cost and add no value, you gain a significant competitive edge and a preemptive value proposition relative to the commission sales business model.

Structural and Cultural Considerations You Must Get Right:

Process and Technology: Contrary to conventional wisdom and industry precedent, process and technology are essential to fulfilling our fiduciary responsibilities and providing continuous comprehensive counsel. Unless we empower the advisor through process and technology, there are

human limitations as to the value that it is possible for the advisor to add. As human beings we can only fathom the three dimensional, or nine possible interrelated outcomes. If we have five hundred clients and want to manage the investment values of risk, return, tax efficiency, liquidity, cost structure and time, and we use the ten thousand investment alternatives available to us, each having one hundred description points, and if we want to add value, we would have to manage a three billion dimensional equation with nine quintillion (eighteen zeros) possible interrelated investment outcomes. This is clearly beyond human comprehension. Clearly process and technology are essential in order to articulate and manage the industry's full range of financial products and services in terms specifically meaningful to each individual client. Process and technology are essential to the fulfillment of our fiduciary obligations. If an advisor is not using a prudent investment process, capable of being held to a fiduciary standard of care, and if the advisor is not using technology to their advantage, it is very unlikely they can be fulfilling their fiduciary obligations. This is certainly true of all advisor support firms that will not acknowledge their advisor's fiduciary obligations.

Cultural Impediments to Fiduciary Counsel: A fiduciary advisor working within a prudent investment process with highly objective criteria for investment manager selection, finds very little utility in the brokerage industry's product management organizational structure designed to distribute financial products in support of commission sales. It is very expensive, adds no value and impedes the development of a process management organizational structure necessary to add value and fulfill fiduciary responsibility. The money, power and status vested with the industry's product management organizational structure, makes it extremely difficult for the brokerage industry to subordinate all its product areas, to an objective prudent process, which will not favor high margin products not in the investors best interests. Product promotion is trumped by prudent process.

The Independent RIA Imperative: By Wall Street fighting the acknowledgement of their advisors fiduciary obligations; and by Wall Street eliciting two unvetted SEC staff interpretations that render fiduciary responsibility irrelevant as a consumer protection and professional standard within NASD member firms; the industry's best and brightest who aspire to a high professional standing, have no choice but to become independent RIAs, working outside a NASD member brokerage firm construct. Without the brokerage industry's acknowledgement of the broker's fiduciary responsibilities, how would a broker act in their client's best interests working within a NASD member firm? Charles Schwab's 3,000 RIAs in Schwab Institutional make a brilliant case for advisors relinquishing their brokerage licenses as previously cited. The consumer clearly prefers advisors who, working in a conflict free business environment, are acting in the investor's best interests. This is a competitive edge RIAs will enjoy until Wall Street acknowledges the fiduciary status of its advisors, creates a conflict free business environment in which its advisors can work, and establishes a prudent investment process, which can be audited back to statute, case law, regulatory opinion letters and best practices ensuring their client's best interests are being served.

ONCE FIDUCIARY COUNSEL IS WITHIN THE REACH OF THE ADVISOR, THE DEBATE OF WHETHER THE ADVISOR DECLARES FIDUCIARY STATUS BECOMES MOOT, IT BECOMES THE CHOICE OF THE ADVISOR NOT THEIR FIRM.

Asset Management Cost Structure: As you streamline the internal support infrastructure of your practice around a prudent investment process, you remove redundant cost which do not add value, in order to maximize your compensation and provide you with pricing advantages. The best way to accomplish this is to move to model portfolios. Model portfolios are the intellectual property or the real time buy/sell research of money managers that generates alpha that tells the advisor what, when and how much to buy to achieve the same result the money manager achieves in their portfolio. Essentially, model portfolios unbundle account administration from the money manager's responsibilities. The benefit is that model portfolios eliminate triple account administration cost (at the money manager level, the advisor level and the trustee level) and reduces the cost of asset management to 25 to 35 basis points. Through sleeveless overlay management technology, like Smartleaf, the advisor performs the account administration function. Each day Smartleaf sends trade recommendations that would automatically optimize all the values cited in investment policy (risk, return, tax efficiency, liquidity, cost structure, etc.) to maintain compliance to each client's custom benchmark. Smartleaf is an expert system that takes you beyond your own technical proficiency to automatically minimize trade execution cost and maximize tax efficiency as per each client's wishes and instructions. Most importantly, model portfolios and Smartleaf literally make you, the advisor, the value added and significantly reduces the cost of asset management to 25 to 35 basis points. The average mutual fund runs 150 basis points plus 100 basis points for trade execution. The average managed account cost 50 basis points. Thus, you take control of your cost structure, the difference accrues to you the advisor as either increased compensation or as latitude in pricing your services. Importantly, your competitors who use mutual funds have to explain why mutual funds cost so much, why they do not provide real-time access to fund holdings, why they can't directly manage values like tax efficiency, risk and cost structure as you can in a model portfolio using an expert overlay management technology. You have a faster, better, cheaper solution and literally take control of your investment process.

Real-time Data Access: In order for you to provide continuous comprehensive counsel, you must have access to real time

information on all client holdings. Managed accounts provide real time access to account holdings but have a very cumbersome and expensive account administration function. This is resolved by you unbundling the alpha generating asset management function from account administration. Here again it makes sense for you to buy model portfolios (real time buy sell research of the manager that generates alpha) from the money manager, the money manager happily gets out of the account administration business (which adds no value for them), and the advisor, using sleeveless overlay management technology at the advisor level, is empowered to expertly manage and administer an unlimited number of custom client accounts. With real-time access to client holdings, you now have access to the information that enables you to provide continuous, comprehensive counsel necessary for fiduciary counsel.

THE 3,000 ADVISORS AT SCHWAB INSTITUTIONAL, WHO HAVE RELINQUISHED THEIR BROKERAGE LICENSES, GARNERED MORE NET NEW ASSETS THAT ALL 60,000 WIREHOUSE ADVISORS COMBINED.

Cost/Capital Requirement: You shouldn't be worried about having to come up with the capital to create your prudent investment process. The cost of you bringing in-house the resources, both staff and technology, necessary creating a preemptive value proposition is less than you are now paying a vendor or your firm to participate in their wrap fee programs. The average wirehouse advisor has between $50 million and $100 million in client assets under advisement. If those assets are in wrap fee/advisory programs, it becomes economically viable for an advisor to bring in-house the staff, technology and resources necessary to build a preemptive value proposition. The average wrap fee program cost 190 basis points, with 50 basis points going to the manager, 70 basis points going to the advisor and 70 basis points going to the program sponsoring firm. At $50 million in assets under advisement you are paying your firm $350,000 to participate in their wrap fee program, at $100 million you are paying them $700,000. By simply redeploying the 70 basis points you are now paying your firm to participate their wrap fee/advisory programs you can bring in-house the staff, technology, custody and trade execution resources necessary to fulfill your fiduciary responsibilities, to create a preemptive value proposition and reconfigure variable cost (the sixty percent plus of your gross revenues your firm keeps) to fixed cost, increasing your margins and the value of your business. Your value proposition is preemptive because wrap fee programs are structured around product silos like mutual funds and cannot accept clients as they are. Clients have assets that do not conform to the narrow range of assets in a wrap fee program or UMA account. Your clients have qualified plan assets, assets held in trust, individual securities, assets not in the wrap fee program, which makes it impossible for you to add value through wrap fee programs. Model portfolios, which give you access to client holdings at the securities level, allow you to incorporate any other client holding entailing individual securities, thus giving you the capability of accepting each client as they are, therefore empowering you to add value in the context of all your client's holdings. A prudent investment process utilizing model portfolios, capable of incorporating all a clients assets and capable of being held to a fiduciary standard of care utilizing sleeveless overlay management; can actually be provided by an RIA at far less cost than a wrap-fee/advisory services program.

Conflicts of Interest/Trading Cost: The concern of whether the advisor is acting in their client's best interest or in their own best interest was an important consideration in the SEC requiring a disclosure statement from all advisors who are not able to declare their fiduciary status. With real-time information the required transparency and full disclosure can easily be automated and reported to create a conflict free business environment. The challenge has been how to treat brokerage commissions. The fiduciary advisor treats trade execution as a cost center while the broker treats it as a profit center. There is an obligation of the fiduciary advisor to manage trade execution on behalf of the consumer as a prudent expert. The most popular way for fiduciary advisors to manage trade execution cost on behalf of each of their clients is to create an omnibus account, which is comprised of all their client's holdings, for each client. Omnibus means the custodian never knows the identity of the advisor's clients. When the advisor has to trade a position, all the orders for that security in all the advisor's accounts are routed and blocked into one trade. Thus consolidating say 100 individual trades into one trade at a low flat fee trading cost. Literally trade execution cost is at least one hundredth of the cost incurred by a broker, assuming the broker will match the flat fee pricing of a discount broker/electronic crossing network/custodian. The cost savings are terrific, resulting in better than best execution. This removes the biggest inhibitor of the brokerage industry in providing a conflict free working environment in which their brokers can work. Your value proposition is preemptive to commission sales, because you have a conflict free business environment in which you can act in your client's best interest and because your prudent investment process is transparent, it is clear to the consumer that you are managing trade execution as a cost center rather than a profit center. This has been the Achilles heal of the brokerage industry. Until trade execution cost can be managed by the brokerage industry as a cost center, RIAs enjoy a significant competitive edge. Trade execution has become the third rail of the financial services industry (see: SENIOR CONSULTANT, July 2004, "The Third Rail of the Financial Services Industry: Trade Execution, Best Execution and Beyond").

Division of Labor: As you build your prudent investment process, it will become clear that complimentary skill sets are

required. You need a Chief Administrative Officer to make all the disparate technology function as a system. You will need a Chief Investment Officer to construct and continuously and comprehensively monitor client portfolios, necessary to fulfill your fiduciary obligations. And the CAO and CIO need you the advisor/CEO to win and serve client relationships to make it all work. Each of the three major divisions of labor requires specialized skills that make the sum of the parts greater than the whole. Thus, the means by which you create a preemptive value proposition is the management of the human resources necessary to consistently execute a prudent investment process without you necessarily having to be involved in every detail. In doing so you create liquid transferable value in your practice. This also argues for a collaboration of a large number of advisors to better manage cost, to make successor management easier to manage and to provide access to the public trading markets as the ideal exit strategy.

Structural Summary: Fiduciary advisors, who are compelled to act in their client's best interests, are forced to work outside NASD member firms that will not acknowledge their advisor's fiduciary obligations. Fiduciary advisors with an objective investment selection process, ascribe little value to the industry's very expensive conventional product management organizational structure designed to support commission sales. As fiduciary advisors streamline their practices around a prudent investment process, cutting out all cost that don't add value, they are taken in a totally different direction than a conventional commission sales support infrastructure. Model portfolios give you access to real-time information necessary for continuous comprehensive counsel, significantly reduce the cost of asset management and through sleeveless overlay management technology you are empowered to manage an incredible degree of portfolio detail necessary to fulfill your fiduciary obligations. Because of real-time data access, the required account transparency is easily automated, which in concert with omnibus block trading, results in a conflict free business environment in which you can work. A prudent investment process can be constructed by you or a third party expert/service bureau, which can be audited back to statute, case law, regulatory opinion letters and best practices, at less expense than you are now paying to participate in a wrap fee program, where it is not possible to add value.

The management of these structural considerations put you in a position to provide the continuous comprehensive counsel required of you to fulfill your fiduciary obligations. The following breakthrough strategic configuration of technology empowers you to manage an extraordinary degree of portfolio detail necessary to fulfill fiduciary responsibility for an unlimited number of custom portfolios while enjoying significant cost savings. Essentially, it is faster, better, cheaper solution to conventional commission sales. It is required by regulatory mandate. It is the right thing to do. It is in the investor's best interest. It is in the advisor's best interest. It is in the industry's best interest. By extension, this basically means we all have a very good reason to change the way we do business. The industry may not want to, but the laws of the free market make the emergence of fiduciary counsel inevitable. Now let's get specific on what the prudent investment process looks like, how much it costs and how you can put together all the enabling resources to create a preemptive value proposition.

IF WE FOCUS ON A FIDUCIARY CONSTRUCT WITH THE INVESTORS BEST INTERESTS IN MIND, WITH NO EXTENUATING CULTURAL OR POLITICAL CONSIDERATIONS, THE INDUSTRY IS TAKEN IN A NEW DIRECTION.

The Prudent Process—Enabling Technology And Cost:

First it is important to note that there are many technological configurations that will empower the advisor to create a preemptive value proposition not possible within an NASD member firm. The technological configuration we reason through here is just one of many. Yours may be different depending upon your approach to portfolio construction, staffing, market segments served and the size of practice. Don't worry about cost or having to be a technological expert. You can collaborate with other RIAs (dividing cost) in building your proprietary support infrastructure—taking control of your cost and value proposition. You can participate in a prepackaged service of a service bureau, which will inexpensively get you in business but it will not be your and your colleague's proprietary solution. Or, you can out source to a vendor like Capital Market Consultants (www.cmarkc.com) for RIA support services. The take away here is to understand what is required and how much it cost in order for you know the appropriate course of action you should to pursue. You have no choice but to act in your client's best interest, the question is how. Hopefully in this research piece, you will find the insight to resolve the many difficult questions that NASD member firm brokers cannot answer. Ultimately this will lead you to the opportunity to win accounts at will with your own preemptive value proposition.

Let's look at how you can redeploy the $350,000 to $700,000 you are now spending to work within your firm's wrap fee programs, to bring in-house within your practice, the staffing, technology and resources necessary for you to create a preemptive value proposition and fulfill your fiduciary responsibilities. We have assumed you or you in association with other advisors have $65 million within your NASD member firm's wrap, UMA or advisory services programs and are now paying $450,000 to your firm to participate in those programs.

Staffing/Professional Development: Client acquisition/service, which is your strength as an advisor, must be separated from portfolio construction/management and administration/operations. This not only frees up more time for client acquisi-

tion and service but you will find others who may be far better suited to portfolio construction and management or administration and operations than you are. By leveraging yourself with expert processes, technology and professional staffing, you have more time and focus on client acquisition and a truly extraordinary level of continuous comprehensive counsel can be provided. If your colleagues assume ownership of their positions and exceed team and client expectations, they become integral to your value proposition and thus become partnership material. Their earnings potential and the value of their equity can be potentially extraordinary as you grow your business. These are potentially world-class positions that require chemistry and complimentary skill sets in order to build a world-class business team. With careful testing and very specific delineation of responsibilities, world-class caliber talent with a commitment to your vision can be assembled.

"RIAs will enjoy this competitive edge until Wall Street creates a conflict free work environment and a prudent process and acknowledges its advisor's fiduciary obligations.

For your Chief Investment Officer position a young MBA from a good school who is eager to work toward becoming a partner should run $55,000 to $75,000. They should be very familiar with modern portfolio theory, be a finance major or CPA, and work with you to establish an investment methodology, portfolio construction and portfolio monitoring function we discuss in more detail in "Manager Search and Selection" which follows later. You should immediately spend $5,000 putting your CIO through the on-line CIMA program offered by IMCA and through the on-line Accredited Fiduciary Auditor (AIF) program offered by the Center for Fiduciary Studies and enroll them in the CFA curriculum with expectations of a date certain satisfactory completion. If you are not a CIMA or AIF you need to complete those courses, as well, which could run another $6,000 if you attend them in person at the Wharton School and the University of Pittsburgh respectively. The CIO has very specific metrics, jointly agreed upon, in order to exceed client and team expectations, as do all positions including yours in client acquisition.

For your Chief Administrative Officer position, an administration/operations person with a strong technology background makes a disparate array of technology seamlessly function as a system. This person should run $65,000 and is partnership potential. Depending upon the technological and custodial service configuration used, you will have objective certification criteria required. You should plan on spending $4,000 putting your CAO through certification programs, systems and operations training to maximize their effectiveness, build excess capacity and drive down your cost. The CAO has specific metrics, jointly agreed upon, in order to exceed client and team expectations.

As you grow, everyone on your high performance business team must leverage them selves. You will create a marketing function to build a never-ending pipeline of prospective clients. The CIO may find it cost effective to engage outside technical resources, the CAO may find it cost effective to approach things differently as well. Inherent in your practice culture are the values that everyone will execute faster, better, cheaper not just because of the scale you achieve but because of initiative and innovation and the latitude that everyone in your practice has to excel at achieving client expectations, at maximizing revenues, at maximizing practice valuation and enhancing compensation for all. We have spent, $155,000 so far of our $450,000 budget, leaving $295,000.

Asset/Liability Study: It is literally not possible to add value unless one can look at a recommendation in the context of all the client's holdings. Only then can we determine if a recommendation improved overall portfolio return, reduced overall portfolio risk or enhanced the tax efficiency, liquidity, cost structure of all the clients holdings as a whole. The asset/liability study objectively evaluates the clients existing portfolio and each of its holdings. It is the "before photograph" from which you find ways to improve the clients financial well being. Most clients have no idea of the return being generated on all their holdings as a portfolio. They have no idea of the risk exposure they are taking. They don't know that they are taking 150% of the markets risk for 50% of its return. They don't know the cost structure of their portfolio: that mutual funds cost 150 basis points not including trading cost or more than three times more than managed accounts at 50 basis points or six times more expensive than model portfolios at 25 or so basis points. They don't know if their portfolio is structured in an income and estate tax efficient manner. In conducting an asset/liability study you will find 20 to 30 ways to materially improve the client's financial well being. Thus the asset/liability study is the reference point from which your client can determine the value you add. It requires quite a bit of work, but 99% of the time, the asset/liability study will make a prospect into a client. The aggregation, verification, reconciliation and management of all a clients holdings held by multiple custodians each with different reporting formats has been cost prohibitive until the recent introduction of account aggregation technology. In an important break through, the cost of the asset/liability has been reduced to nearly zero with the advent of model portfolios.

Through the use of model portfolios the Trust Company Model and the Investment Management Consulting Model are converging, which changes how we approach the asset/liability study and account aggregation. In the trust model, the advisor manages all the client's assets as a portfolio manager, so there is no need for account aggregation. Thus account aggregation cost is nominal because structurally you are managing all the clients' assets. Any holding to include model portfolios, that can be defined in terms of individual

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securities can be easily integrated at little or no extra cost. Using Smartleaf, your proprietary prudent investment process is actually faster, better, cheaper than the conventional trust company model because rather than the trust company reviewing client holdings once a year against goals and objectives (as required by OCC Regulation 9) with Smartleaf every day you review holdings against goals and objectives as well as a broad range of values cited in investment policy. Any liquid holdings that cannot be incorporated require extra expense that may not be cost justified by the consumer, requiring those holdings to be replaced with assets with a more amenable faster, better, cheaper format.

IT IS CHEAPER FOR YOU TO BRING IN-HOUSE THE RESOURCES, STAFFING AND TECHNOLOGY NECESSARY TO CREATE A PREEMPTIVE VALUE PROPOSITION THAN TO PARTICIPATE IN A WRAP FEE PROGRAM.

If you use model portfolios in the investment management consulting model, using Smartleaf for sleeveless overlay management, you are essentially acting in the same capacity as the trust company, thus the literal convergence of the trust company and investment management consulting. Rather than manage managers, the investment management consultant is managing the manager's model portfolio.

For advisors who use the grossed up (higher cost and complexity that adds no value) packaged products incorporating an unlimited number of reporting formats that must be verified, reconciled and managed, you need to budget $65,000 the first year for account aggregation for the first 220 accounts plus $140 for each additional account. In year two, that drops to $45,000. Depending upon your account structure (oil leases, art, real estate, operation businesses, timber, farm land, etc.) account aggregation can be more expensive than what we have budgeted for. Assuming a less complex account structure, we have budgeted $65,000 for account aggregation technology available from a number of vendors. This cost drops to $45,000 in year two. As advisors, who use conventional packaged products, gravitate toward model portfolios, ultimately account aggregation cost will decline to $500 per new account. Thus for the purposes of this discussion, we assume the advisor is in a transition period, where by the end of year two all accounts have been converted to a prudent process utilizing model portfolios, budgeting $65,000 in year one, $45,000 in year two, and $10,000 in year three for account aggregation. This leaves $230,000 in our budget.

Investment Policy: Investment policy is essential to your fulfilling your fiduciary obligations and is the key to cementing a long-term client relationships. Investment policy establishes the role and responsibilities of all parties, criteria for hiring and firing managers/vendors, delineates the clients goals and objectives, establishes the investment and administrative values to be addressed and managed, formulates investment strategy, defines the client in very specific terms, establishes and manages client expectations citing deliverables and metrics to be used in your prudent investment process (asset/liability study, investment policy, investment strategy, manager search and selection, performance monitor, tactical asset allocation). Clients learn more about your services, your professional standing and the value you add in the process of creating a policy statement than at any other time. In your client interview, before each question you establish what you seek to accomplish and literally explain the consideration, thus providing you a venue to show case your competency and the care you bring to your work. Though it is not uncommon that eighty percent of a client's policy statement is likely to be similar to another, the challenge is you just don't know which 20% is different as each client is unique. In order to save hundreds of man-hours that you could expend in creating custom policy statements for each of your clients, www.MyInvestmentPolicy.com has created world-class investment policy templates with legal opinions that state the policy statement and the associated portfolio are in compliance with the appropriate regulatory authority whether UPIA, ERISA, UMIFA or UMPERS. If you want to deviate outside of the template you can, with the guidance of expert legal counsel for an additional fee. For individuals, the IPS runs $90 for one IPS, $6,500 or $65 each for the first 100 or $9,000 or $45 each for the first 200. For institutions (defined benefit, defined contribution, foundations and endowments, Taft-Hartley, public funds, profit sharing plans) investment policy statements run $500 each. These policy statements, with legal opinions, retail for between $5,000 and $15,000.

For established clients, you may choose to formulate your policy statement based on what you now know about them and then seek confirmation to expedite the process. By integrating Klein decisions K4 into your client interview, you gain a technology utilizing conjoint reasoning and utility theory, where you can mathematically weight what is uniquely important to each client resulting in a custom benchmark against which their portfolio will be built. This is the same technology used in medical diagnostics. K4 is extremely important as half the equation in developing an investment strategy and constructing a portfolio is defining the client's goals and objectives precisely right. K4 gets it precisely right. K4 is also helpful in performance monitoring as you can measure each client's portfolio against each clients specific wishes making results more meaningful. The client signs off on your mutual understanding of what is important to them.

We have assumed your practice is principally focused on individual investors and that you have 200 clients, thus your cost and pricing structure for investment policy statements is $9,000, leaving us with $221,000 in our budget. K4 cost $15,000 to $30,000 to create a custom application tying the K4 custom client profiling/benchmarking establishing what each client portfolio should look like to the

K4 manager search and selection engine which cost $5,000 for model portfolios, mutual funds, managed accounts, collective funds, ETFs, etc. research. There are extraordinary efficiency gains in an advisor mastering the client profile, investment strategy and manager search and selection within one system. Thus, we are budgeting $20,000 for K4, leaving $201,000 in our budget.

Investment Strategy/Strategic Asset Allocation: The creation of investment strategy or strategic asset allocation has been largely based on the research of Brinson, Hood and Beebower (1986) and Brinson, Hood and Singer (1991) which found that 93.6% of investment returns were attributable to being in the right asset classes and less than 5% of returns were attributable to being in the right investment. Thus by focusing on the right configuration of asset classes, rather than specific investment selection, you gain a mechanism, which will provide 93.6% of the return. Based upon the historical performance characteristics of asset classes, any number of strategic asset allocation programs can help you formulate an investment strategy. More recently Ibbotson and Kaplan (2001) confirmed that 90% of the variability of returns across time was explained by asset allocation policy. However when Ibbotson and Kaplan asked the question differently to determine how much the variation in returns is explained by differences in asset allocation policy, Ibbotson and Kaplan found asset allocation policy accounted for about 40 of the differences between two funds performances. Asset allocation is clearly an important determinant of performance, but not so important that all other considerations can be ignored. Which takes us to the tactical asset allocation question to be discussed later.

SLEEVELESS OVERLAY MANAGEMENT TECHNOLOGY AT THE ADVISOR LEVEL, ELIMINATES REPETITIOUS TRIPLE ACCOUNT ADMINISTRATION COST THAT ADDS NO VALUE, CUTS ASSET MANAGEMENT COST TO 25 TO 35 BPS, AND FACILITATES AN EXTRAORDINARY DEGREE OF PORTFOLIO DETAIL TO BE MANAGED IN EACH ACCOUNT

There are a number of strategic asset allocation tools from multiple sources, which have almost become commodities. You will want to go beyond strategic asset allocation and use tools like Monte Carlo simulation, which helps explain to individuals the random nature of the capital markets and explains risk and the probability of achieving returns in a more understandable manner than institutional metrics like standard deviation. We have budgeted $3,500 for tools like Monte Carlo simulation that help you better formulate investment strategy. This leaves us with $197,500 in our budget.

Manager Search and Selection: We have already budgeted $20,000 for K4 that includes the databases for manager search and selection. By using model portfolios, we are deconstructing packaged products to make them less expensive, easier to manage and more responsive to real time information/analytics. In order to manage real time information, decentralized sleeveless overlay management technology, like Smartleaf, managed by the advisor at the advisor level will automatically optimize values (risk, return, tax efficiency, liquidity cost structure, etc.) cited in investment policy as often as daily. Each day Smartleaf will generate a trade recommendation report providing the rationale for trades which will optimize each client portfolio. The portfolio is not traded every day to manage trading cost and tax efficiency as instructed by expert systems per each client's custom directive for tax minimization. Smartleaf integrated into K4, would electronically manage an incredible degree of portfolio detail for an unlimited number of custom client portfolios. This configuration of technology is the continuous comprehensive counsel required of us to fulfill our fiduciary responsibilities. Smartleaf runs eight basis points or $45,500 on $65 million in assets. Like other technologies, with scale, technology cost decline, which argues for advisor collaboration in building scale and driving down cost. We are assuming you have $65 million under advisement, thus Smartleaf would run $45,500. Thus our remaining budget is $152,000.

Performance Monitor: Even with your CIO in place and the extraordinary technological capability of K4 and Smartleaf in place that automatically optimize tax, risk and expense values cited in investment policy for an unlimited number of custom portfolios, you still need to evaluate each client model portfolio relative to its custom benchmark. You need to establish the daily performance (alpha) of the model, the value of the opportunity cost of what you didn't know by absolute return attribution analysis to determine which industry, sector and securities bets were paying off, and you need to evaluate the active weightings of each portfolio utilizing fundamental criteria. This will tell you and your clients anything you want to know in real time about any of your client's custom portfolios, without having to wait 30 to 45 days after the end of the quarter. One of the most exciting aspects of dealing with real time information and web-based technology is that we can take data beyond one-dimensional performance reporting and use it more dynamically to manage client's portfolios. This real time attribution analysis and analytics require Bull Run Financial at $12,000 and $10,000 for to links to Quantal. This leaves us with $130,000 in our budget. To more immediately assess manager performance, adjusted for style bias, for a clearer more accurate view of managers, PPCA's PODs and PIPODs run $1,100, which takes our budget to $128,900.

Real time reporting, trade and order routing, and sub accounting essential for model portfolios and omnibus block trading is your core technology. Systems like Advent's Moxie (trade and order routing) and Axys (sub accounting) have been very popular, around which advisors have built their practices. These web based AIMR compliant systems can automatically re-

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port on any configuration of assets, automatically rebalance portfolios and offer extensive training and support. Market Street Advisors makes sense for a thousand accounts or more and Charles River makes sense for large applications. We have budgeted Advent at $75,000 the first year and $25,000 the second year. Which takes us to a $53,900.

Tactical Asset Allocation: Every advisor wants to literally add value in absolute terms, yet most supporting NASD member firms have been reticent to acknowledge their advisors render investment advice because they and their advisors would then be accountable for their investment recommendations. They don't believe their advisors are capable of adding value through active management, a view shared by many academicians (when current market conditions contradict historical precedent such as when fixed income out performs equities, even academicians agree it would be foolish to follow historic precedent—thus the case for tactical asset allocation). The solution is for the advisor to use the active management of passive (index funds) investment vehicles by engaging firms like Dimensional Fund Advisors, to construct portfolios on you behalf. Or, you could use Frank Russell or SEI, and draw upon their expertise to use active managers to beat the benchmarks and create alpha, for each of your client portfolios. Each of these firms have $40 billion plus under advisement. Or, you can use outsourced investment methodology like RowPyn's Equity Investment Rotation (EIR) model. EIR, which has been evaluated and documented by the University of Chicago's Institute of Securities Pricing and Research, beats the market by 70% with the same beta as the market over the past nine years. Because we have assumed each advisor would build their own proprietary prudent investment process, we assume the advisor would engage the EIR model from RowPyn at ten basis points or $50,000, which brings our budget to $3,900.

SUMMARY:

If you or a collective group of advisors or brokers have $65 million with in a wrap fee, UMA or advisory services program within a NASD member brokerage firm and you cannot declare your fiduciary status or act in your clients best interests and are required to use a disclosure statement that says in writing you are not required to act in your clients best interests; you can create a preemptive and predatory value proposition at less cost than you are now paying to participate in your firm's wrap, UMA or advisory services program. Consumers have vested trust in the counsel their investment advisors provide and will insist their advisors will act in their best interests and fulfill their fiduciary obligations. It is a strategic imperative for advisors to work in a conflict free business environment, to work within a prudent investment process that can be audited back to statute, case law and regulatory opinion letter to assure they are fulfilling their fiduciary obligations. It is the right thing to do, is required by regulatory mandate, it is in the clients best interests. The consumer is the ultimate arbiter of what is in their best interests, and there are far more consumers who want value to be added and their advisors to fulfill their fiduciary responsibilities than there are advisors who are capable and/or have the latitude of doing so. Given the NASD member brokerage firms are not supportive of fiduciary counsel, given the industries major trade groups have not challenged the two unvetted SEC staff interpretations which make fiduciary counsel irrelevant as a consumer protection and professional standard within NASD member firms, fiduciary counsel must become a professional imperative. I urge all advisors to join the Society of Fiduciary Advisors so access to enabling resources can be democratized, our definition of fiduciary counsel can be expanded and refined, and fiduciary counsel can be brought within the reach of all. ■