ADVISOR POST

New medicine for sales culture

JONATHAN CHEVREAU
Well-Advised

YVONNE BERG FOR NATIONAL POST

Ted Rechtshaffen, CEO of TriDelta: Advisors still feel pressure to sell a small group of products rather than the best ones available.

Everybody says "it starts with the clients." But in practice, the needs of clients of the financial services industry often come a distant third to those of shareholders or advisors.

Now, before you dismiss this as an anti-advisor rant from yours truly, consider the actual source. It's from Ted Rechtshaffen, who has founded a new independent financial planning firm precisely because he believes the industry has its priorities backward.

Rechtshaffen is CEO of Toronto-based TriDelta Financial Partners (www.tridelta.ca), a multidisciplinary financial planning firm established earlier this year.

Rechtshaffen — who once worked with Dan Richards at what was then Marketing Solutions before moving to the client side with RBC Dominion Securities — says there have always been client-focused advisors; however, "because of the structure of our industry, they always face challenges."

Certainly the last years have generated much talk about how the industry can get more client-focused. The move from transactions- to fee-based compensation is one of these seismic shifts (even though many, including myself, believe the old model can be more cost effective for clients). Another move is away from in-house, or proprietary, funds to open architecture and access to a full range of products.

In short, if the industry is to become the genuine profession it aspires to be, the relationship with clients cannot be primarily sales driven but must resemble the medical model of doctor and patient.

Rechtshaffen observed that despite these needs, advisors are still under pressure to sell products rather than offer solutions. Many are under the gun to meet higher sales targets. As has been noted previously here, the prevailing sales culture often takes the form of posting names of top monthly sales "producers" in branch offices — rather than the top performing client portfolios and the advisors responsible for same.

Rechtshaffen says many advisors still feel pressure to sell a small group of products rather than the best ones available.

So he and 10 partners raised the seed capital for TriDelta, a fee-based provider of holistic financial planning. This entails "subbing out" the separate disciplines of debt management, home mortgages, estate planning, insurance, retirement planning and, of course, investment management.

Rechtshaffen likens this to old-time family doctors or general practitioners. A focus on client net worth means tackling client liabilities as well as assets. That often means a home mortgage, so TriDelta partners with leading mortgage brokers to minimize interest charges. A similar approach is taken with insurance, investments and anything else falling in the broad financial planning orbit.

For the investing piece, TriDelta sells no in-house investments but contracts out to four suppliers.

These include the firm profiled here last column: Hahn Investment Stewards, plus PWL Capital Inc., Wickham Investment Counsel and Guardian Capital Advisors (more on Guardian below).

Except for Wickham, which takes an active approach to investments, the other three take a largely passive approach to investing by providing portfolios of index funds or exchange-traded funds. Fees are at institutional rates.

On an after-tax basis, TriDelta is "certainly cheaper than mutual funds," Rechtshaffen says, "Many of our clients have been sold lots of mutual funds but had not been provided with integrated financial solutions. We said we're not out to cut your fees in half, we're out to grow your net worth."

The fee clients see is 1.95% for the minimum client account of $100,000, dropping to 1.5% for $250,000 and 1.25% at $750,000. It falls to 1% for every dollar over $1-million and is negotiable at that point.

That includes the fees charged by the four investment management providers (around 50 basis points), but to get the all-in fee you need to add in the MERs of the underlying investments (typically 20 to 25 basis points).

The financial planners hired must adhere to this philosophy and hold either a CFP or RFP (Certified or Registered Financial Planner). They are paid a salary plus bonus tied to the overall size of the book of business. It grows as the investments grow.

One of TriDelta's partners is Guardian Capital. Two-and-a-half years ago — partly in response to media criticism of the industry's high fees — Guardian launched ETFolios (www.etfolios.com). Managing director Mark Yamada says advisors still have the most influence over retail investing decisions but many savvy clients are "fed up with funds."

However, they aren't clear about what they pay in fees. Guardian has learned early adopters of ETFolios have "more money to invest than we thought." While the minimum is $50,000, the average ETFolio account is $150,000.

Guardian's experience has been similar to that of Hahn's, Yamada says. "Investors intellectually understand indexing but viscerally want to beat the market."

ETFolios attempt to provide the best of both worlds by taking a core and explore approach to portfolio construction. At least half the portfolio must be in core ETFs for which Guardian charges 50 basis points (0.5%). Clients and advisors can tweak up to half of the rest with a more tactical approach, for which it charges 150 basis points (1.5%). Again, the underlying MERs of the ETFs are above and beyond this charge. Thus the all-in fee for the core portfolio, which provides beta or market exposure, should range from 0.7% to 0.75%.

Those aiming to beat the market can pay 1.5% (plus the ETF MERs) for a crack at obtaining "alpha" by timing purchases of various regional or sector ETFs.

Yamada calls the approach "mass customization." Guardian has more than 1,200 different portfolios to choose from.

Guardian also pays an additional 1% referral fee to advisors who send "do-it-yourself" clients to ETFolios. That way, Guardian can recognize the role of relationship managers like TriDelta and the "estate, tax and financial planning that they provide."

This transparent approach to unbundling fees puts all costs on the table for clients. That, Yamada says, is "the future."

Let's hope so.

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jchevreau@nationalpost.com

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ZSA-X: THE FINANCIAL SERVICES EXCHANGE

SHELF SPACE

For internal use only: the commission grid

HUGH ANDERSON

Have you ever asked any of your clients how much they think you get of the commissions and fees they pay? The answers might surprise you.

A while back I asked some of my former clients that question. Most knew that the money was split between the firm and me, and figured it was generally fifty-fifty. Dream on, you say. In fact, the average split is around two-thirds for the firm and one-third for the average experienced broker.

The nasty big secret of the retail full-service business is that the payout policies of most firms still reward production more richly than any of the other things the industry talks about: portfolio management, financial planning, or plain good service. Rookie brokers quickly learn that the way to stand well with the branch manager is to qualify for the list of top producers published monthly in the branch, not by helping clients get the best possible return on their investments.

This works through the so-called cash payout grid. This is a table, usually on one sheet of paper and usually marked "for internal use only," that sets out the percentage split that the firm will pay the individual broker. Down the left side are gross commission and fee production levels in ascending order. Across the top are transaction commission sizes, also in ascending order.

The details vary from firm to firm, but the percentage split for the individual broker starts very small and rises with increased sales production and the size of the order. For example, a typical grid will usually give even a big producer just 20% of a minimum $100 commission. Many firms pay out nothing on an order that generates less than the minimum commission, even to multimillion-dollar producers.

On a larger order generating a commission of, say, $300, a broker producing $300,000 gross a year could still just get 35%. On the same order a broker whose clients paid him a million-dollars-plus in commissions in the past year might receive close to 50%, but only at the more generous firms.

In the training schemes the big brokerage firms run, new brokers are told they will succeed if they look after the long-term interests of all their clients — conservative investors as well as active traders. They should act as investment advisors, not just commission sales people. They should take the time to get to know their clients' needs, establish an investment strategy and review the accounts regularly to make sure things are going well.

But rookie brokers quickly learn that the grid rules make this very difficult to do. Taking the time to provide long-term financial planning to mostly conservative investors is a fast way to starve. To make a decent income, many brokers take on far more clients than they can service properly — preferably including some active big-dollar clients who demand a lot of time but whose more frequent transactions provide a larger commission split.

Clients who don't qualify for that degree of attention typically get called by their broker only when one or more of their investments is coming up for renewal. Brokers will also seek to persuade such clients to transfer in any investments they may have elsewhere in order to make them potentially more rewarding.

Some less scrupulous brokers may also resort to a strategy that industry insiders call "churn and burn." This means persuading an unwary client to make a lot of trades. If those trades turn out to be profitable, well and good. If not, it's time to move on to another similar client.

Despite the discouraging environment, I do know that many full-service brokers still do their best to provide good investment services to their clients. If you are one of them, and really only you will know, I salute you.

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Hugh Anderson is a freelance journalist and a former retail broker.
hughie@unclehughie.com