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SPECIAL REPORT

2008 Center for Due Diligence Post-Conference Report

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Dear InvestmentNews Reader:

The CFDD's 6th annual Advisor Conference was another success. We would like to thank the exhibitors, sponsors and over 1,000 registrants for making the CFDD's 2008 Advisor Conference the retirement plans industry's event of the year. We are particularly grateful to the advisors that helped develop the bottom-up event and to the 100+ individuals who participated in the agenda.

The agenda was populated by a "*Who's Who in the Retirement Industry*" and the sessions in the following pages provide a glimpse into the content rich topics that were covered. Based on audience feedback, our speakers clearly distinguished themselves. They also provided unique insights into the complex and ever-transforming retirement plans industry.

We would also like to thank Tom Bruns and Gene Huxhold from John Hancock Retirement Services for once again assuming the role of Title Sponsor for our second annual Charity Golf Event. The generous amount of money raised for the Injured Marine Semper Fi Fund was particularly gratifying. The men and women in our armed forces do not make policy, but they carry a heavy burden. That burden must not be forgotten.

In addition to a challenging economic environment, the retirement plans market has matured. While major consolidation is ahead at all levels, retirement plan specialists could continue to increase market share through BOR consolidation. Specialists must, however, adapt to changing conditions, a rapidly evolving industry, manage liability and develop prudent wealth management strategies. Specialists must also improve practice management skills, communicate their value and professionalize marketing efforts.

Our 2009 Advisor Conference agenda will continue to be populated with recognized experts and the industry's most accomplished retirement plan advisors. Our advisor-centric approach will remain focused on growth opportunities, practice management and the industry's transformation. The pre-conference activities will change direction and offer unique social activities for enhanced networking.

The CFDD's October 5-7, 2009 Advisor Conference will once again be held at the Fairmont Scottsdale Princess Resort. More accomplished retirement plan advisors attend the CFDD's Advisor Conference than any other industry event and we look forward to seeing you next year.

The 2009 conference will feature an Old/Wild West theme and the winner of the grand prize drawing on the last day will be awarded an all expense paid vacation for two at one of the nation's top dude ranches.

Phillip Chiricotti

Phillip Chiricotti
President
Center for Due Diligence

The Voice Of Independent Retirement Advisors

Table of Contents

"Business opportunities and increased market share will come at the expense of others."

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President, Center for Due Diligence

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Is 'extreme makeover' coming?

Financial crisis heightens scrutiny of 401(k) plans

Plan sponsors, advisers and providers should brace themselves for major changes likely to result from intensifying government scrutiny of 401(k) plans in the wake of the global financial crisis, according to Fred Reish, a nationally recognized Employee Retirement Income Security Act (ERISA) attorney.

The crisis has caused average Americans "to live in fear of their retirement and the investments they've set aside," Reish said in a keynote address at CFDD's 2008 Advisor Conference. "That is fundamentally wrong. What a lot of people are feeling today… borders on depression. Something is wrong with the system, and it has got to get fixed."

In this environment, specialized and focused 401(k) advisers will prevail, said Reish, managing director of Reish Luftman Reicher & Cohen in Los Angeles. Advisers, he added, must become "success consultants," advising plan sponsors not just about choosing quality investments, but about all aspects of operating a successful retirement plan, including how to evaluate fees and expenses, increase participation and deferral rates, and implement automatic enrollment. "Results are going to be major," he said, urging advisers to benchmark every major function of an employer's plan "to help the plan sponsor progress toward success."

> *"Things are changing. They're going to change big time. Our world is being rocked."*

Even before the financial crisis, mounting evidence that Americans are failing to save enough for retirement had triggered 401(k) rule changes designed to transform 401(k) plans from savings plans into retirement plans, Reish said. These changes, including automatic enrollment and quality default investment alternatives (QDIAs), underscored that "there's only one measure for a successful retirement plan: Does it provide adequate retirement benefits?" he said.

The financial crisis has turned up the heat on 401(k) plans, with lawmakers questioning whether the plans are "inherently too risky," Reish said. He cited an interview in which U.S. Rep. George Miller, D-Calif., chairman of the House Education and Labor Committee, likened 401(k) plans to a "riverboat gambler" and said the committee would consider "an extreme makeover" of 401(k)s. "So things are changing," Reish said. "They're going to change big time. Our world is being rocked."

At an Oct. 7 hearing conducted by the committee, Teresa Ghilarducci, an economics professor at The New School for Social Research in New York, called 401(k) plans a failed experiment and suggested that Congress let plan participants trade their 401(k) assets to the government in return for a guaranteed retirement account composed of government bonds and administered by the Social Security Administration. Under Ghilarducci's plan, employees would be required to defer 5% of their annual pay into the account. The government would provide an annual deposit of $600 and would guarantee an annual return of 3% over the inflation rate. Most of the $80 billion in current tax breaks on 401(k) contributions and earnings would be eliminated.

With the Congressional Budget Office reporting $2 trillion in losses from retirement savings during the last 15 months, Ghilarducci's plan has caught the attention of Miller and U.S. Rep. Jim McDermott, D-Wash., chairman of the House Ways and Means Committee's Subcommittee on Income Security and Family Support. The plan would replace about 70% of a worker's income at retirement. "Can you beat that?" Reish asked CFDD attendees. "What's the expense ratio of that? Next to nothing. Can you beat that?" The plan also would cover 100% of workers. "What's the coverage of 401(k) plans generally – 45% , 43% or 40%?" Reish said. "How are you going to beat that?"

Reish said he doesn't know if Ghilarducci's plan will become reality. But with many experts predicting Democrats would expand

Fred Reish

their control over the House and Senate in the November election, the plan could be a sign of things to come. "It is certainly a benchmark by which we can begin to measure our efforts by redefining what success means," Reish said.

As new rules continue to transform 401(k) plans into retirement plans, and as lawmakers contemplate 401(k) alternatives, the legal and practical burdens of developing a successful retirement plan "are being shifted off the plan sponsor onto the industry," Reish said. "There's going to be more and more responsibility on the plan sponsor to make the plans work, but there will be less and less burden on the plan sponsor…because the whole industry is going to solve it for the plan sponsor."

Most plan sponsors, he added, lack the expertise to operate 401(k) plans effectively. They also don't want to be fiduciaries and worry about being sued over plan investments. As "success consultants," advisers must offer solutions for reducing this burden, Reish said. Most plan participants, meanwhile, lack the knowledge and perspective to use 401(k) plans effectively, he said, predicting a continued trend toward automatic enrollment, automatic deferral increases and automatic investments. "Auto to the third power," he said. "That's where we're going, because we're going to get smarter." ■

After the election

The new president will face major issues involving taxes, regulations

The man who takes office as U.S. president in January 2009 will inherit an economic crisis that will affect virtually every aspect of the retirement planning universe, according to Kathryn Capage, first vice president and strategic planning director for Invesco Aim's Tax-Advantaged Products Division.

In a session called "Legislative Update 2008: What's Up on Capitol Hill," she prepared advisers for the changes that might be coming. "You need to be ahead of the game in terms of what's coming up from a regulatory or legislative perspective," she said.

The first reality is that the new president will be facing huge budget deficits: The projected deficit for 2009 is $482 billion, which is almost three times the 2007 deficit of $162 billion. This reality will affect the spending and taxation plans of the new administration and Congress, she said. But also affecting those plans will be a basic difference in perspective between Republicans and Democrats.

Since the days of Franklin D. Roosevelt, Democrats have championed a community society, Capage said. This philosophy, which has been advanced through programs like Social Security, Medicare and employer pension plans, holds that government and the employer should help individuals bear the responsibility for preparing for retirement. Republicans, on the other hand, believe in an ownership society that transfers responsibility for retirement onto the individual. The move away from defined benefit plans and toward employee-funded defined contribution plans has been one of the few victories for the ownership society in recent years, Capage said.

This basic difference in philosophy will continue to shape lawmakers' responses to major economic questions, she said. For example, Social Security is expected to run out of money by 2041, buried under the weight of 78 million baby boomers who started filing for benefits in 2008. The GOP response to this looming shortfall has been to call for partial privatizing of Social Security by allowing participants to put some of their FICA tax into individual accounts invested in the market. This plan does not seem to be gaining traction, especially in the current market environment, so some Republicans plan to call for additional private accounts into which individuals could put extra FICA payments, she said. Democrats, on the other hand, usually call for raising taxes and/or reducing benefits for the wealthy.

Kathryn Capage

Medicare is an even more immediate crisis than Social Security, Capage said, because the Medicare trust fund may be exhausted by 2019. What kind of reform eventually will be passed remains unclear. But, Capage told advisers, "Stay as independent from the Medicare program as you can."

Efforts to reform retirement plans are focusing on many of the same areas addressed in the Pension Protection Act, she said. For example, the failure of participants to participate in plans or to defer enough money is being countered by automatic enrollment, which she called "the sexiest words in Congress today."

The Department of Labor continues to work on regulations regarding fees, and its efforts are aimed at requiring adviser disclosure of direct compensation of $5,000 or more, indirect compensation of $1,000 or more, and conflicts of interest, although the regulations are not complete.

> *"With the economic situation as it is, there's no guarantee that any of this will happen as they want."*

Finally, Capage talked about tax law changes. Many tax cuts are scheduled to expire on Dec. 31, 2010, including the estate-tax cut ("2010 is a great year to die," she said.), income-tax cuts, and cuts in taxes on capital gains and dividends. During the campaign, John McCain said he would keep all these tax cuts if elected, while Barack Obama said he would keep tax cuts for the middle class and increase taxes for households earning more than $250,000, which Capage called Obama's "line in the sand."

Democrats also have made it clear they would like to get rid of the Alternative Minimum Tax, Capage said. But, she said, the AMT raises huge amounts of revenue, which will make it difficult for Democrats to eliminate it.

In fact, she said, the new economic realities probably will significantly affect the tax changes the new administration and Congress are able to enact. "With the economic situation as it is, there's no guarantee that any of this will happen as they want," she said.

Finding common ground

Panel discusses how advisers and wholesalers can work together

Advisers have some simple suggestions for wholesalers who want to work with them to serve retirement plan sponsors and participants: Know your own business, know our business, and respect our efforts and the efforts of our clients.

In a pre-conference session for wholesalers, a group of advisers who had been wholesalers discussed their real-life experiences – good and bad – in a panel called "What Advisors Want from Wholesalers: A View from the Trenches." The panel was moderated by Thomas Herbruck, vice president of financial services for Herbruck Alder, and included Samuel Brandwein, vice president with Citigroup/Smith Barney; Stace Hilbrant, managing director and founder of 401k Advisors LLC; and Mark Paone, corporate retirement director, Citi Institutional Consulting.

> *"Make sure you do keep in touch, just like in times like these, we have to keep in touch with our clients."*

First, the panelists said, wholesalers should understand their own business and represent their company well. Hilbrant said that several months ago, when he was conducting a vendor review, one of the wholesalers presenting at the review came late, was unprepared, and delivered a presentation that was insulting to many of the people at the review.

Paone agreed that he also has dealt with wholesalers who were not prepared for their presentations, including some who did not even have a basic understanding of the organization they represent. "At a minimum, you would like to think that the lead person representing a provider organization would know everything about their organization," he said. But that is not always the case.

Lack of preparation and poor presentations don't only reflect badly on the wholesaler, Paone emphasized; they also make the adviser look bad for having invited the wholesaler into the discussion.

The panel also urged wholesalers to make an effort to understand the adviser's business and the business of the plan sponsor. Hilbrant said that during a recent vendor replacement search, he offered the wholesalers involved the opportunity to sit down with the search committee to discuss the issues that were important to the committee. Only one wholesaler accepted the invitation, Hilbrant said, and that firm ended up getting the business, mainly because it was able to address the things that mattered to the committee.

"This seems so simple, but often people don't do the simple thing," Hilbrant said.

Brandwein told of a recent experience in which a wholesaler was in his office as Brandwein was busy fielding calls from plan participants made nervous by the current financial unrest. Feeling bad about all the interruptions, Brandwein offered to reschedule the meeting. But the wholesaler asked if instead he could stay around and listen to what Brandwein was telling participants because it would help him to better understand Brandwein's business. "That was something that really impressed me," Brandwein said.

Part of understanding the adviser's business includes having an understanding of the time constraints that advisers face, the panel said. "By far the biggest challenge we have in our business is time," Brandwein said. He said too often wholesalers just launch right into their pitch, without asking him if he has time to talk. Being respectful of the adviser's time "is 10 times more important now, with what's going on in the market," he said, explaining that in this difficult market, advisers are fielding many more calls from nervous plan sponsors and participants.

> *"We owe it to our clients to learn about all the best providers that are out there."*

However, Paone said, wholesalers need to find a balance between calling advisers too much and never calling them at all. He said that although he has had wholesalers who called way too often, he also has had experiences in which a wholesaler did not call at all after a meeting.

> *"You have to begin by bringing something to my practice that I can use."*

"Make sure you do keep in touch, just like in times like these, we have to keep in touch with our clients," he said.

Brandwein added that wholesalers can help advisers by being able to offer some value-added services such as compliance-approved materials to distribute to plan participants. But, he cautioned, "First and foremost, they have to have a good product, or all the value-added in the world won't help."

Finally, the panel offered suggestions to wholesalers who are looking for a way to initiate a business relationship with an adviser.

"You have to begin by bringing something to my practice that I can use," such as research or literature, Hilbrant said, adding that although that seems like an obvious idea, it is surprisingly rare.

Paone said, "Approach me just like I would approach a plan sponsor that didn't know me – just pick up the phone." However, he said, the wholesaler should be prepared with an understanding of the adviser's business and ways in which the wholesaler can help the adviser.

Brandwein agreed that wholesalers who can explain quickly and succinctly what they can bring to an adviser are more likely to get the adviser to listen.

And, he said, it is important for advisers to be open to the possibility of dealing with new wholesalers. "We owe it to our clients to learn about all the best providers that are out there," he said. ■

Becoming an 'ethos adviser'

Advisory role demands leadership, public-service mentality

Amid the uncertainties created by the global financial crisis, retirement-plan advisers must strive to be seen as leaders by their clients to ensure strong, enduring relationships, according to Don Trone, president of the Foundation for Fiduciary Studies.

"If you're not, you're never going to have their trust and confidence," Trone said during a keynote address at CFDD's 2008 Advisor Conference. "Furthermore, those who are going to be truly successful at this profession will be those who recognize the fact that their role is a form of public service."

Trone predicted that ethos will become "the executive power word" for the next decade. Ethos means the distinguishing character, sentiment, moral nature or guiding beliefs of a person, group or institution. "We're going to be sitting down and defining our organizational, our professional ethos," he said, noting that "ethos is the actualization of our victory over our own petty self-interests."

Of particular importance to advisers will be the notion of fiduciary ethos, which calls for advisers to be leaders who have no conflicts of interest and who recognize that they are performing a public service because the government alone cannot safeguard investors' assets adequately, Trone said.

Characteristics of the "ethos adviser" include a sincere commitment and courage to develop goals and objectives in the best interests of clients; the discipline to develop long-term strategies; the patience and courage to evaluate events calmly against the backdrop of uncertainty; an ability, based on an understanding of personal and organizational strengths and weaknesses, to determine when delegation and outsourcing are appropriate; and the ability to get the right things done, Trone said.

Fiduciary ethos, he said, is the antithesis of a proposal issued last August by the U.S. Department of Labor to clarify how advice can be given to 401(k) plan participants under the Pension Protection Act of 2006. The proposal would enable mutual funds and other investment companies, if they meet certain conditions, to provide advice directly to plan participants, a practice effectively prohibited in the past because of conflict-of-interest concerns.

Trone said the proposal weakens the fiduciary foundation of the Employee Retirement Income Security Act (ERISA) and the original intent of the Pension Protection Act, which set an "unqualified fiduciary standard" for advising plan participants.

The proposal demonstrates that regulations alone never will protect plan participants fully, and underscores the need for advisers to embrace fiduciary ethos, said Trone, who also serves as the director of the U.S. Coast Guard Academy Institute for Leadership and as chief executive officer of Fiduciary Ethos, which provides training and publications on the leadership and fiduciary dimensions of investment decision-makers.

A cornerstone of fiduciary ethos is stewardship, the careful and responsible management of something entrusted to one's care, he said. "If we're going to begin to mitigate the definition of fiduciary with proposals (like the DOL proposal), maybe we need to fall back on our concept of stewardship, because after all, a fiduciary is nothing more than a steward clothed in a legal shawl," he said.

Another cornerstone of fiduciary ethos is the notion of a covenant. "The covenanter is bound to a promise…and does not expect to be fairly compensated for the value of services rendered," Trone said. "Perhaps we need to be thinking more of covenanter relationships with our clients as opposed to contracts."

Fiduciary ethos for advisers is a process

Don Trone

> *"Ethos is the actualization of our victory over our own petty self-interests."*

that involves five decision-making dimensions, each of which requires a specific leadership dimension, Trone said. The process includes the following steps:

1) **Analyze.** State goals and objectives. Define roles and responsibilities of decision-makers. Brief decision-makers about applicable laws, regulations and policy statements. Leadership dimension: judgment, including commitment, capacity to care, vision and inspiration.

2) **Strategize.** Identify sources and levels of risk. Also identify assets, time horizons and expected outcomes. Leadership dimension: innovation, including creativity, risk-taking, curiosity and ability to embrace change.

3) **Formalize.** Define the strategy that is consistent with rate. Ensure the strategy is consistent with implementation and monitoring constraints. Formalize the strategy in a detailed, written policy statement. Leadership dimension: decisiveness, including relationships/alliances, empowerment/delegation and good communication skills.

4) **Implement.** Define the processes for selecting experts, tools, techniques and vehicles to implement the strategy. Ensure that service agreements and contracts do not contain provisions that conflict with objectives. Leadership dimension: courage, including expertise, high energy, self-confidence and being in the field.

5) **Monitor.** Prepare periodic reports that compare performance with objectives and that analyze costs, performance and objectives. Conduct periodic examinations for conflicts of interest and self-dealing, and prepare periodic qualitative reviews of decision-makers. Leadership dimension: integrity, including trust, ethics, respect, honesty, perseverance, coaching/mentoring and understanding human nature. ■

Looking at both sides

Advisers, providers weigh benefits and dangers of new options

A variety of new products holds great potential for retirement plans and the advisers who work with them. However, plan sponsors and advisers need to exercise caution before jumping in feet first.

That was the message of a session called "New Retirement Income Products: Threat & Opportunity for Advisors." The panel included moderator Joe Masterson, senior vice president of Diversified Investment Advisors, and panelists Tom Bruns, divisional vice president, John Hancock Retirement Plan Services; Mitch Welsch, a financial adviser for UBS; Dan Beckman, vice president-product management, Fidelity Investments; and Dorann Cafaro, founder of Cafaro Greenleaf.

The panel focused on annuities with market protection features and packaged money management with mutual funds. Bruns and Beckman discussed versions of these products offered by their companies, noting that they are generating lots of interest in light of investors' uneasiness with market volatility. "My guess is that these kinds of things will continually evolve," Bruns said.

Advisers on the panel agreed that these types of products could help to calm investors' nerves. However, they voiced some concerns.

First, Cafaro said, these products might not be a good fit for every plan. For example, she said they would have greater appeal to employers with many workers nearing retirement or those who hope to keep employees for their whole career, rather than companies with young workers and a lot of turnover.

She also noted that these products have very little historical track record on which to evaluate them. Is it a fiduciary decision to offer these products? And if so, on what does the fiduciary base the decision?

She and Welsch urged advisers to think about whether the products are portable and flexible. What happens if the plan sponsor wants to stop doing business with the provider that offers one of these products? What happens if the company that offers the product decides after several years that it is not profitable, and drops it? How does the product fit into the plan sponsor's current plan and can it work with their current record-keeping?

Welsch added that these products are not familiar to employees, so employers who add them to plans also have to make sure employees understand them. "Putting people into the right product may mean we have to educate them," he said.

In fact, the panel emphasized the need to educate employees not only about specific products, but also about the need to save more for retirement overall. In order to use an annuity-type product, an employee has to have enough money to make the payment meaningful.

"You don't want to go into a product where immediately you are guaranteed to be shopping in the cat-food aisle," Masterson said.

Looking for a better deal

Advisers find ETFs, CITs can add options at a lower cost

Defined contribution plans are becoming an increasing part of the business of many advisers, and the sponsors of those plans are looking for ways to add choices without adding to costs. A panel of advisers and providers explored some specific ways to approach this issue in a panel called "Expanded Use of Low-Cost Funds & the Future of ETFs in the DC Marketplace."

Moderator Antonio Ferreira, managing director of Cogent Research LLC, opened the discussion with some research conducted by his company. Three out of four advisers currently sell 401(k) plans, and that will increase to eight of 10 by 2010, according to the Cogent study. In addition, the study shows that the average adviser's assets under management in 401(k) plans will increase by 39% – to $10.75 million from $7.75 million – by 2010. More and more advisers are looking for ways to serve the 401(k) market.

The panelists – who included Gregory Porteous, national sales manager of iShares 401(k), Barclays Global Investors; Jamie Kitchens, chief investment officer, National Retirement Partners; Mark Volker, senior vice president, SunGard Wealth Management; and Steve Ferber, senior vice president of the Defined Contribution Practice, PIMCO – talked about how advisers can use exchange-traded funds (ETFs) and collective investment trusts (CITs) with the retirement plans they advise.

Porteous and Ferber noted that passively managed ETFs and CITs can provide advisers and plan sponsors with more options at a lower cost. And this is important to advisers and their clients, the panel agreed.

"At the end of the day, what advisers want is choice," Volker said. "They want to add value, and they want to be able to demonstrate to their clients that they add value."

However, panelists noted that ETFs and CITs are not for every plan. CITs, for example, only can exist within a qualified retirement plan. They cannot be rolled over into an individual account like an IRA – which also means that advisers might have a bigger challenge turning a plan participant client into an individual wealth management client.

The providers and the advisers on the panel agreed that as advisers have become more comfortable with ETFs for all their clients, they have become more likely to suggest ETFs to their retirement plan clients. But some ETFs might be too exotic for most retirement plans, Kitchens said, noting that they might be too complex for many plan participants to understand, and they might offer greater diversification than a retirement plan needs.

Advisers recommending ETFs to their plan sponsor clients need to choose ETFs that are appropriate for each plan. "If you're in a fiduciary position, you need to keep the participants in mind, and your loyalty has to be to them first," he said. ■

Covering the bases

Advisers leaving a firm should plan carefully before making the move

For advisers seeking to go independent or move to another broker-dealer, there are lots of issues to consider. But perhaps the most critical was covered in a session called "Who Owns the Client?"

Moderator Lisa Shidler, a reporter for *InvestmentNews*, explained the confusion surrounding the issue. In 2004, the major wirehouses developed a protocol that was designed to allow advisers to take basic client information when they left the wirehouse, but some advisers say the protocol is not being followed. At the same time, courts have been unclear on whether advisers can take client information with them to a new broker-dealer or to an independent firm. For example, the Supreme Court of Ohio has ruled that a client list, even if it is memorized rather than written down, is protected as a trade secret. But a recent California Supreme Court ruling seems to loosen restrictions on client information. Regulatory attempts still have not answered the question fully, she said.

> *"Hope for the best when working with your old firm, but prepare for the worst."*

Panelist Timothy Mahota, chief compliance officer with Partnervest Securities Inc., explained that the issue involves balancing the firm's responsibility to guard the client's information with the client's right to go with the adviser leaving the firm.

This confusion is especially difficult, Shidler said, because more advisers might be considering going independent as a result of the current financial crisis. Many big wirehouses and broker-dealers are struggling, she said, and are less likely to provide advisers with incentives to stay.

But even in this environment, "Everyone will fight tooth and nail to retain their advisers," said Bo Bohanan, director of retirement plan consulting for Raymond James Financial.

Advisers considering leaving a broker-dealer should keep their intentions quiet, advised Darla Sipolt, vice president of sales for TD Ameritrade Institutional. If the broker-dealer finds out about the plan, the adviser could end up without a job, she said.

Dorann Cafaro, founder of Cafaro Greenleaf, said that when she decided to become an independent adviser, she made sure all her plans were in place before she made the announcement. And even though she did not have a non-compete clause and had a good relationship with the firm she was leaving, she was not allowed to take anything with her when she left. In fact, she said, she had to leave her computer, which she had paid for. The firm removed all the data from the computer before returning it to her.

Panelists offered several suggestions to advisers considering making a switch:

- Have a lawyer review your agreement with your current firm and give you advice about how to leave that firm and go to or set up another. Also have a lawyer read any agreement you sign with a new broker-dealer. "You should go into your move thinking about what happens if you want to move again," Mahota said.
- Be prepared to contact your clients yourself. Most firms will not tell clients where an adviser went. When your clients call up and ask for you, your former firm probably will say that you are no longer with the firm and direct the clients to another adviser.
- If you are considering a move, don't put your clients into funds that are proprietary to your current firm. In this economic environment, clients may be unwilling to sell investments at a loss in order to follow you.
- Make sure your clients have copies of any financial documents, such as wills, that they might have left with you. You probably will not be allowed to take these documents with you when you leave.
- Understand what will happen to your pay when you leave. Cafaro said that her former firm paid commissions for work done before she left. But with fee-based business, the firm owns the fees when they are paid, so she did not get fees paid after she left. "Make sure you stay through your fee-based pay date," she said.

Panelists also noted that even if an adviser prepares carefully for the move, it probably will not go exactly according to plan. "Hope for the best when working with your old firm, but prepare for the worst," Mahota said.

Still, Cafaro said that she did not regret making the move, and in fact wished she had made it sooner, despite the hassles involved.

"Bottom line, if it's the right move for you, it's worth it," she said.

Back from left: Timothy Mahota, Dorann Cafaro, Bo Bohanan, Front from left: Darla Sipolt, Lisa Shidler

Selling on your terms

Thoughtful succession planning can yield multiple benefits

Succession planning pays for advisers – and not just in the long run.

Research shows that advisory firms with a written succession plan generate 23% more revenue per principal than firms without a plan produce, according to Ray Henderson, director of Business Health, PTY., Ltd., an Australia-based practice-management company. Firms with an effective written plan – one that identifies a successor, includes a funding structure and is regularly reviewed – do even better, generating 86% more revenue per principal.

Yet only 12% of advisory firms have a clearly documented succession plan, Henderson said at a CFDD conference session entitled "Are You Succeeding in Succession?" He urged advisers to get started on their succession plan now and to revisit it annually. Noting that a quarter of firms with succession plans have no structured funding arrangement, he urged advisers to build a funding structure into their plans. "Where is the money going to come from? The funding is absolutely critical," he said.

When it comes to selling their practice, advisers can sell internally, externally or "to the devil," Henderson said. The last option, he noted, is basically a fire sale and "means going out on someone else's terms." By evaluating their business and planning properly, advisers can ensure they go out on their terms. "Remember, it's about planning for succession, not planning for selling," Henderson said. "There's a big difference." Proper succession planning, he added, encompasses client succession, management succession and ownership succession.

In considering client succession, advisers should think about how dependent their firm is on them. Could the firm serve clients with continuity in the adviser's absence? A good test is to ask staff members to list a firm's top five clients, and to see if each staffer lists the same names, Henderson said. "We find that often doesn't happen," he said.

Advisers also should consider how their clients would react if they were to leave. Henderson cited research indicating that 36% of advisory clients would stay with a firm if their adviser left. That doesn't mean the remainder would leave, but it's definitely a risk if a business is too dependent on one person, he said. The same research shows that clients like dealing with more than one adviser at a firm. To increase the likelihood that clients will stay, advisers should take a team approach to building client relationships, Henderson said.

"If you want to succeed in succession, you can't do it all yourself," he said. "The very successful businesses we see around the world have a team approach." This approach includes seeking help from outside resources, such as a broker-dealer, when developing a succession plan, he said.

To ensure that management succession goes smoothly, advisers must focus on hiring and developing the right people, building financially capable buyers, identifying the skills needed for the adviser's role and the owner's role, and developing a picture of what their firm will look like organizationally after a sale. Once advisers have identified a potential internal successor, they should allow that person to "dig into" the business, learning its finances and other intricacies beyond the person's job description, Henderson said.

In planning ownership succession, advisers should define clearly what is being transferred. Is it assets? A book of business? Staff? An office? Advisers also should identify deal-killers early and should get legal and tax issues under control sooner rather than later. "Work out what it is you want to do first…and then get the lawyer involved early, but not too early," Henderson said.

The value of an advisory firm is in the eye of the buyer, not the seller, he said. Advisers should conduct the "mirror test," asking themselves if they would buy their business and why or why not, Henderson said. Advisers also should evaluate what is being sold, whether alliances and associated companies will be included in the sale, and the strategic fit with a prospective buyer. The industry standard for the selling price of a practice today is generally two or two-and-a-half times revenue, but a firm "is only worth what someone is willing to pay," said Henderson, who expects due diligence focused on financials, business health and strategic fit to become more exacting.

Although it has been common to measure a firm's value in terms of multiples of recurring revenue, this practice likely will change, he said. "Any really careful person doing due diligence will say, 'Give me a look at a whole range of numbers,' " he said. Additional ways of measuring value include multiples of cash flow and earnings before interest and taxes (EBIT), as well as discounted cash flow, which is becoming a more common valuation tool, he said. Advisers also should remember valuation factors such as expenses, profitability, sale costs, and a firm's recent performance.

> *"If you want to succeed in succession, you can't do it all yourself."*

Due diligence regarding business health will require clearly documented systems and processes, measurements of client and staff satisfaction, and a current compliance audit, Henderson said. Assessments of a firm's market profile, recent history and dependence on its principal also will be important. If a firm is too dependent on a departing principal, then it is "less healthy than it needs to be for somebody else…to write a big check," he said.

In assessing strategic fit, it's important to consider factors such as ease of integration, consistency of approach and philosophy, client demography, and compatibility of systems, processes and products, he said.

"The very best businesses will get the very best price irrespective of what happens in the marketplace," said Henderson, who foresees a growing need for comprehensive succession plans. Today, U.S. financial advisers on average are 57, and "it's a seller's market," he said. "That's going to very quickly flip around, and in the future there will be a lot more discerning buyers who will look a lot more closely at businesses." ■

'A perfect storm'

Financial crisis, other factors pose significant challenges for advisers

The current financial crisis, along with other factors such as increasing litigation and a maturing of the 401(k) marketplace, have created "a perfect storm," and it will take courage and skill to navigate through it, CFDD President Phil Chiricotti said.

Speaking in the final keynote address of the CFDD 2008 Advisor Conference, Chiricotti outlined the challenges advisers are facing.

First is the financial crisis, which has created great hardship for investors and advisers alike. Investors have seen their portfolios shrink, which in turn means that advisers' assets under management — and any fees based on those assets — also have shrunk. At the same time, fewer investors are putting new money into their portfolios, either because they don't have money to invest or they don't have confidence in the market.

> *"If the market doesn't recover, the tooth fairy's not coming."*

Chiricotti noted that despite the dramatic efforts of the United States and other nations, this crisis is proving to be difficult to fix. "This is not your father's recession," he said, explaining that the financial problems that began with a derivative-driven crisis in the housing industry not only have spread to other industries, but also are affecting every level of government. Federal, state and local governments don't have the money to run their programs and fix their infrastructures, he said, and this is likely to lead to higher taxes and reduced benefits, which will constrict consumer spending — and investment — even further.

In addition, he said, the financial services industry will see an increase in litigation at all levels. "Litigation increases when customers lose money," Chiricotti said. Smaller plan sponsors may decide to simply terminate plans rather than respond to litigation, he said, and this will constrict even more the market for defined-contribution (DC) plans.

Chiricotti said he believes the DC market is becoming a mature market, and there will not be much more new growth. Most new opportunity for advisers will come from winning business from someone else, he said, and asset growth — and the growth of fees for advisers — will be linked to the performance of money in existing plans. That performance is tied to the performance of the equity market, he said, adding, "If the market doesn't recover, the tooth fairy's not coming."

Chiricotti also cautioned advisers that, "A sustained recovery in equities is not possible without a sustained recovery in the economy." And, he said, that recovery probably is still a long way off.

So how can advisers continue to do business in this market? Chiricotti said that successful advisers will become more efficient businesspeople. They need to improve efficiency and lower costs, develop their human capital and work hard to keep their existing clients.

They also have to manage their liability exposure, which is especially important as litigation increases, he said. He urged advisers to take a hard look at the coverage their plans have and at the exposure they might have because of inadequate or nonexistent coverage by the plans. "You need to elevate your approach to liability management," he said.

And, Chiricotti said, successful advisers will learn to leverage their existing clients and relationships, identify new growth opportunities and do a better job of marketing. It is not necessary to spend a lot of money on marketing, he said, but advisers need to be innovative and professional. "You can distinguish yourself with professional marketing," he said.

He also suggested that some defined-contribution plan advisers might consider expanding into wealth management. But making that transition will not be easy, he cautioned. "If you're going to do it, you need to think about it in advance and have a strategy worked out," he said.

Chiricotti said he believes the industry is in a transitional period, in which it struggles to adapt to changing economic realities, many of which will be long-lasting. He noted that the economic growth of the last few decades came primarily from the entry of a second parent into the workforce and the huge increase in home values. But home prices have deflated, and there are few non-working parents, so growth is going to have to come from somewhere else, he said, adding that it is not clear yet where that might be.

"We need to see some growth to solve this," he said. "How do we get the growth? We're not going to get it tomorrow."

That means that advisers are going to have to hone their business model and become more efficient, more focused and more professional if they want to survive until the economy recovers, Chiricotti said. ■

Phil Chiricotti


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