

For a fresh look at opportunities and problems in wealth management, U.S. advisors might do well to look across the Atlantic.

RULE BRITANNIA

By Vanessa Drucker

FEE-ONLY FINANCIAL PLANNING AND wealth management emerged in the U.S. in their modern forms. But while U.S. pioneers remain at the profession's cutting edge, they could still learn something from advisors in other countries. By neglecting other models—especially those in the United Kingdom—American advisors may be missing interesting insights. The U.K. contingent may, in fact, become better placed in the future to leapfrog some of the hurdles—like increasing government scrutiny—developing in the U.S. Having already witnessed the wealth management revolution, they will not be surprised by the challenge. “The writing is on the wall,” says Samuel Adams, London-based head of Financial Advisor Services Europe at Dimensional Fund Advisors. “They know the best practices and need not invent new software or platforms to support them.”

Advisors in the U.K. know and handle a wide range of activities—from mortgages, pensions and estate and tax planning to investments, insurance and life planning. The same goes for wealth managers, Adams asserts. “In the U.S., wealth management might mean investments and some estate tax planning for intergenerational purposes, while here in the U.K. it encompasses everything.”

Barry Horner, executive director at Paradigm Norton Financial Planning, runs a 30-person firm near Bristol, England. In addition to planning, investments and tax, estate and philanthropic strategies, Horner arranges family weekend conferences at



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country hotels where he chairs intergenerational discussions.

It is not surprising that planners in the U.S. tend to live primarily in the investment space, since the roaring markets of the 1980s and 1990s kindled clients' enthusiasm for the chase. But according to Harold Evensky of Evensky & Katz in Coral Gables, Fla., "Despite progress over the past decade and considerable discussion of holistic processes, we still have more advertising copy than substance."

A product- and investment-centric culture leads to churning, argues Mark Ralphs of Financial Planning Corporation in Southport, England. He points to the recent enthusiasm for hedge funds as an example of a popular "flavor of the month." In his view, U.S. planners over-trade and use rebalancing as a justification.

Consider the range of Ralphs' own "concierge service for entrepreneurs." When one of his British clients recently decided to buy a penthouse in St. Petersburg, Fla., Ralphs coordinated accountants and attorneys, arranged for the client's company to vote a dividend to provide funds for the purchase, and located an interior designer to furnish the apartment. For another client, he negotiated the sale of a business division, structuring a deal around tax advantages for both parties. In a third case, he orchestrated an "amicable divorce"—involving legal, tax and human elements—between partners in an engineering business who had "fallen out of love" after 35 years.

"We are expected to know thoroughly and handle all legal and tax aspects," Ralphs reports. In the U.S., individuals get some tax breaks in the form of IRAs, Keoghs, 401(k)s and Roth IRAs. In the U.K., investing is much more tax-driven. For example, Venture Capital Trusts, which encourage investment in smaller companies, give individuals 40 percent upfront income tax relief if they retain their shares for three years.

Planners in the States are more likely to delegate some tasks to "go-to" professionals. According to a report by Cerulli Associates, registered investment advisors in the U.S. are "becoming specialists within their

firms for core service offerings, and networking with other experts to provide specialty services." The report proposes that "it may become a better practice to bring specialists in-house," as some best-practice firms, and especially wealth managers, have done.

In particular, Adams suggests, U.S. planners might add focus to managing the liability side of a client's finances, such as mortgages and insurance. Solutions to risk management include life, disability, property and casualty insurance, as well as long-term care provisions. "Typically, these are not addressed in great depth in the U.S.," says Evensky.

In the U.K., planners are allowed to offset fees from any insurance commissions they may receive from selling products. This would be difficult to replicate in the U.S., where offsets—or rebates—are illegal in most states. However, Brian Robertson at Next Gen Advisor in Charlotte, N.C., has devised a solution. He charges clients on an hourly basis, but deducts his fees for advice from any commissions he obtains. No rebate is involved because he accepts no money from his clients until the transaction is complete.

A GLOBAL OUTLOOK

The U.K. may be small, but it has broad horizons. Although it can no longer be said that the sun never sets on the British Empire, much of that international mindset has survived. Whether they are dealing with their clients' offshore real estate, bank accounts or investment portfolios, British planners are relatively comfortable dealing with foreign assets.

Many of Horner's flock have second homes in a roster of countries: Morocco, Malta, France, Italy, Spain and the U.S. One operates a hotel in Marrakesh; another cultivates an olive grove in Tuscany. Horner is always ready to help them set up bank financing in other countries and deal with foreign tax-planning issues.

Over the decades, British investors have become accustomed to the concept of offshore investing. **Malcolm Greenhill, a principal at San Francisco-based Sterling Futures, emigrated from England 30 years ago. He recalls that "It was considered sensible in the 1980's for British expatriates to**

open accounts in offshore havens and receive interest payments gross of tax. In the U.S., offshore accounts still have a murky, tax-evasive connotation."

Non-U.S. markets, however, have often outperformed the S&P on a long-term basis. Planners here have been slow to react, but are finally embracing more global exposure, according to Patricia Houlihan, who advises clients from Reston, Va. "Living through 2002 and 2003 taught them that lesson!" She notes that many have increased international equity allocations to between 5 percent and 30 percent.

It is a sad reflection though, adds Houlihan, who chaired the Financial Planning Standards Board in 2000 and 2001, that when the group convened in Philadelphia two years ago, few members bothered to stay for the international meeting. Noel Maye, the organization's current CEO, suggests that U.S. planners broaden their knowledge of overseas investing and taxes and also develop a network of professionals for referrals in other countries.

In the U.K., a sophisticated planner like Bristol-based Christopher Dunkerley allocates equity portfolios across the globe. Dunkerley divides the world into six geographic regions: North America, the U.K., Europe, Asia, Japan and emerging markets. Attempting to capture the benefits of non-correlation and diversification, he invests in at least four of these at any time, using at least three fund managers per region. He tries to pick funds with diverse characteristics, in terms of style, size, growth/value, etc. Although he is a firm believer in efficient markets, Dunkerley says, "I see the most dynamic opportunities behind different geographic areas."

Global and currency diversification apply to fixed income as well as equities. Ian Shipway, an advisor with Thinc Destini Wealth Management in Camberley, England, maintains [pound] sterling exposure to give his U.K. clients short-term liquidity. For medium-term liquidity, he introduces an element of unhedged, high-quality bond exposure to hedge against a decline in sterling. Moving out toward a 10-year horizon, he allocates about half his fixed income in-

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vestments to the U.K., with the remainder divided among bonds denominated in all the major currencies. "For the long term, we keep a significant proportion of our real assets—both equities and property—in international markets."

Shipway protects his clients' purchasing power in sterling. "As a nation that relies very heavily upon trade, we hedge future risk by buying exposure to foreign productive capacity."

REGULATION MISERY

The U.K. planning industry has evolved considerably since its origins as an object of public mistrust. Even popular media reflected the skepticism. Television fans of the hit soap opera "Coronation Street" might recall that the arch villain and serial killer was a financial planner. The TV con man exemplified an attitude toward a business tainted with scandals and opaque products.

In a sweeping effort to restore public confidence, the British government instituted a strong and often intrusive compliance regime under the Financial Services Authority, which was formally consolidated in 2001. The FSA regulates investments, pensions, mortgages and insurance, oversees most aspects of financial planning, and requires planners to produce records to verify compliance.

Whenever planners recommend an investment, they must send clients a detailed "reasons why" or "suitability" letter, which also explains why the recommendation is preferable to similar alternatives. ("Rebalancing" is an insufficient reason.) Sales must be registered and documented for six years. "It is generally meaningless and unhelpful," says Horner. "Plus, it usually regurgitates what the client already knows."

A substantial back-office team is needed to generate this avalanche of paperwork. Smaller firms must face the implications of costs, both in time and salaries, which produce no added value. Recent stipulations require that planners send out a mailing to all clients outlining a menu of charges and another disclosure to indicate whether the planner uses fees, commissions or both. All this communication and record storage

adds up to about an additional 10 percent a year in expenses, Horner estimates.

Since they so clearly resent the extreme scrutiny of the FSA, what can British planners teach their American counterparts about surviving under strict regulation? For one thing, U.K. planners have learned to integrate and build the requisite compliance into their regular processes. Ralphs, for instance, has weekly conversations with his compliance consultant, who also works a full day each month in Ralphs' offices. Documentation must be stored and readily accessible, if needed for an investigation. (The SEC might audit you every five years; U.K. planners can expect monthly, quarterly or annual visits, often conducted as spot checks.)

Beyond the grumbling, advisors can gain certain benefits from the discipline of streamlined processes. Efficient document management and integrated IT systems lead to better-run operations. Moreover, some of the compulsory steps mandated by the FSA are directed toward a better understanding of each client's individual needs.

"U.S. wealth managers, who tend to see compliance as an annoyance or a checklist, don't realize how good they have it!" says Adams. Their processes would be "crippled" by such a proactive compliance regime, he adds. **Independent U.S. planners would dread being placed under the type of restrictions that apply to the wirehouses and are overseen by the National Association of Securities Dealers, shudders Greenhill. "That's an important reason we go out on our own, to have the freedom to talk and write to clients without pre-approvals."**

But they had better begin to get ready for their own heightened regulation. Scandals in the U.S.—such as the debacle over mutual fund pricing—are waiting to come out of the woodwork, Ralphs warns. "Eventually they will catch up, and they will trigger a draconian response." A "minority" of best-practice firms have designated a compliance guru, according to Cerulli Associates, but "regulatory issues of the recent past caused many retail firms to wish they were among those select few."

Nor is the U.K. unique in its increasing emphasis on regulation. "More and more compli-

ance issues are turning up in other domains as well—such as Australia, New Zealand and South Africa," comments Nick Cann, CEO at the Institute of Financial Planning.

DEADWOOD

One consequence of intensified regulation in the U.K. has been a pruning of low-profit clients. Because of the compliance framework, a static book of business is tantamount to a liability, Adams explains. Those "dead" clients, who never generated significant revenues, "can still come back to sue you."

In the U.S., a planner might be tempted to take on say, \$100,000 in assets under management, on the principle that the incremental business is not costing much at the margin. Adams believes that if U.S. planners regarded the dead clients as a cost—rather than a revenue center—their businesses would become healthier and their processes more robust.

On the other hand, turning clients away—even "dead" ones—is no way to grow bigger. Evensky points out that, "In today's world, you need a scale to be able to deliver the necessary services and afford the depth of in-house tax and legal advice."

AN ONGOING DIALOGUE

As the FSA explores new rulemaking, it engages in a work-shadowing program: FSA staff members spend time at advisory firms, building up practical insight into the day-to-day activities of an advisor. Regulation does not need to be a one-way street in any jurisdiction. "Because financial planning is such a new profession, we have an opportunity to fit in between the cracks in regulatory schemes around the world," says Maye.

As the U.S. moves in the inevitable direction of added oversight, American planners can prepare to help shape regulation in meaningful ways—even to educate the regulators. They will certainly need to build up their own infrastructures to cope with new rules. At the same time, they can take some responsibility for ensuring that the ultimate framework reflects the realities of their business.

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