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Registered

Rep[®]

IN THE ASSET-GATHERING RACE,
EVEN THE GREAT MERRILL LYNCH
IS GETTING SCHOOLED BY SCHWAB
INSTITUTIONAL.

WHEN WILL MERRILL ROLL OUT
-FOR REAL-ITS OWN RIA
INSTITUTIONAL PLATFORM?

BULLFIGHT

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When Management Pushes Managed Accounts

All the major firms are doing it. If you think there are better investment options for your clients, tell management in writing (and keep copies). You will be better protected in the event your firm tries to terminate you.

I work for a major firm, which constantly pressures us to move our clients' assets into managed wrap accounts. We're being sent subtle,—and not-so-subtle—reminders about why these programs are in our clients' best interest. My manager regularly says large positions in one stock are best liquidated and invested in the firm's managed money program over the long-term. I hate this approach; it's expensive. The performance is nothing great, and I lose a little bit of control over the client relationship. Is this pressure the same at all the majors? How do I avoid this approach without getting myself fired?

Encounter a situation at work that makes you uncomfortable? Hesitant to change firms because you're unclear how your clients could be affected? Don't fret. Send your questions to Registered Rep. Contributing Editor Ann Therese Palmer at at.palmer@penton.com. Then look for an answer in a future Ethical Rep column. Anonymity guaranteed.

The Ethical Rep.
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After the tech bubble burst in 2000, large firms began encouraging reps to shift clients into managed “wrap accounts,” turning reps into asset “hunters and gatherers” instead of true providers of investment advice.

There are several reasons behind this trend. All the big firms were seriously burned by the tech meltdown. There were tens of thousands of customer complaints and arbitrations. The firms collectively paid hundreds of millions in awards and legal fees to customers whose accounts were concentrated in tech-heavy positions that were recommended by the firms. The firms themselves were often the underwriters of these same securities. By encouraging reps to move client funds into managed “wrap accounts,” the firms shift liability for poor performance or losses to the outside managers who actually take control over clients' assets.

In the meantime, these wrap accounts also allow the firms to earn an annual “wrap” fee, typically anywhere from

0.5 to 1 percent of the assets under management for doing very little—if anything—in the way of research or allocation. After all, the outside manager makes all of the selections. This allows firms to downsize their back-office functions, which don't contribute anything to the bottom line. And because they are not otherwise occupied with making individual investment recommendations, reps are then freed up to focus on gathering assets to be placed into these wrap accounts. Bottom line: For the firms, wrap accounts mean more assets, more fees, more profit and less overhead. So they are not likely to go away any time soon.

The best way to protect yourself from being pressured into doing something you don't think is in the client's best interest is to document your position with management. Send an email or memo (remember to keep copies) to management outlining why you don't think a managed wrap account is in a particular client's best interest. If you're later

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terminated by the firm, you will have a strong case for bad-faith termination if you have such paperwork indicating you were doing what you thought was in the client's best interest.

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There's no question the street was revolutionized by the asset manager/fee-in-lieu business model as an alter-

native to one driven by transactions and commissions.

The rationale behind this new model makes superficial sense. First, the fee-based model annuitizes revenue for the firm and broker, and makes it less susceptible to the markets—more predictable and less dependent on turnover. Second, in theory, it eviscerates incentives for churning (i.e. trading excessively), arguably removing churning as a weapon for plaintiffs' lawyers. And third, at a time when financial products are getting more complex, it's unrealistic to expect a broker to become equally conversant with all segments of the market. By putting the rep in charge of gathering assets, which are then turned over to third-party managers with specialized expertise, a higher level of professionalism (at least in theory) may be achieved.

The fee-in-lieu model has been adopted by virtually all wirehouses, and is now part of a larger strategy to control all the customers' financial affairs from womb to tomb, wedding him or her inextricably to the firm through financial relationships. From the firm's perspective, if it manages the customer's banking, brokerage and insurance needs through fee-based relationships, it becomes more difficult and less advantageous for the customer to sever the relationship with the institution. In essence, he or she becomes the firm's customer, not the broker's. That way, if the broker were to leave the business or join the competition, the firm has a better chance to retain the business for itself.

To specifically address your ques-