What Investors and Trustees Should Know about Investment Advice

(and about Schultz Collins, Inc.)

April 2019

Note: the following paper updates the original August 2016 version.

A Peculiar Email

Here is an unsolicited email received from the Wealth Investment Exchange on April 18, 2019:

> *The Wealth investment Exchange is a two day event where investment managers are paired with key investment decision makers at RIA, family offices and bank trusts, who are looking to source new investment strategies for their firm and clients. Participants connect in appointment based one-on-one meetings for a conversation and deeper dive into new strategies….your complimentary invitation includes:*
>
> - *Roundtrip airfare to the event*
> - *Airport transfers when arriving and leaving*
> - *Two night's accommodations at the destination resort [The Langham Huntington Hotel in Pasadena, CA]*
> - *12+ one-on-one meetings with fund managers of your choice*
> - *All scheduled meals and receptions*
> - *Directory of all participants*

Wow! A chance to meet the most impressive managers on the globe, stay in a luxury resort all expenses paid, and learn from the other "Independent" RIAs who attend – all for the benefit of clients. Nothing fishy going on here!

By contrast to the exciting offer to learn about investment excellence in a luxurious hotel setting, here is a somewhat prosaic description of Schultz Collins:

> *Schultz Collins, Inc., is a firm operating within the financial products and services industry. Specifically, it is an independent investment counsel firm registered with the Security and Exchange Commission as a Registered Investment Advisor under the Investment Advisors Act of 1940. Its business model is a fee-only investment advisory. When providing investment advisory services, it acknowledges that it acts as a fiduciary within the scope of the engagement.*

Yawn, and so what? There's nothing about world-class investment opportunities, global networks, award-winning research, proprietary market-beating strategies, top quintile track record, or any other distinguishing trait designed to capture an investor's attention and imagination. There's nothing about

making money! Worse yet, there's nothing about trustworthiness, unique philosophy and approach, experience, or other confidence-inducing claims. Why?

Topics

This essay asks, and briefly answers, several questions:

- Do you need an investment adviser?
- Is investment planning complicated?
- Who provides investment advice?
- What's the difference among an investment adviser,[1] a wealth manager, an investment consultant, a registered representative, a wealth adviser, and a dozen other titles and certifications?
- Is the advice provided by financial professionals valuable?
- What's the difference between a fee-only adviser and a fee-based adviser?
- What is a 'Credence Good?'
- What is an 'Agency Cost?'
- What is a 'Fiduciary?'
- Why is a 'Fiduciary' standard important?

The essay intends to be deliberately provocative – some would say deliberately biased – because it offers a counterweight to marketing propaganda promulgated throughout the money management industry.[2] Although its goal is to generate thought-provoking insights, it is not a weighty academic tome providing detailed legal or quantitative evidence at every turn. With this in mind, let's begin.

Thieves, Rogues, and Charlatans?

A 2016 editorial opinion in an online investment newspaper[3] aimed at financial planners states:

> *The financial planning profession … is fraught with deception and outright thievery. Just follow the news and you'll see one episode after another. Large firms are fined monthly. Trusted financial advisers, including some very prominent fee-only advisors, too frequently violate their clients' fiduciary trust.*

A working paper produced at the University of Chicago[4] provides a disturbing survey of US financial advisers. Among the conclusions:

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[1] There are two accepted spellings: 'adviser' and 'advisor.' When citing a specific statute such as the Investment Advisers Act of 1940, the "er" ending is required. Otherwise, there does not appear to be a standardized or preferred spelling of the term.

[2] We use the term industry as it is used in the 1992 Brookings Institute study: *The Structure and Performance of the Money Management Industry*. The study provides a description of conflicts of interest ("agency problems") and information distortions that characterize how the industry functions.

[3] http://www.investmentnews.com/article/20160207/FREE/302079993/industry-needs-to-rid-itself-of-misleading-labels

[4] "The Market for Financial Adviser Misconduct," (February 26, 2016).

- Roughly one in thirteen practicing advisers have misconduct records;[5]
- Forty-four percent of advisers who lose their job after a finding of misconduct are rehired in the financial industry within a year;
- Certain firms are more likely than others to hire advisors fired for misconduct;
- Firms likely to engage in misconduct often target elderly investors with high incomes;
- Some of the highest rates of misconduct occur at some of the largest financial advisory firms ("some firms 'specialize' in misconduct"); and,
- Despite broad-scope misconduct, some firms attract sophisticated consumers through advertising campaigns promoting images suggestive of a favorable reputation.

The highest rate of advisor misconduct over the period 2005 through 2015 is found in Madison County, New York, which exhibits an incredible 32.06% misconduct rate among advisers. If you want to decrease the likelihood that your adviser is a crook, move to Franklin County, Pennsylvania, where the adviser misconduct rate is only 2.63%.

The highest incidence of misconduct occurs at the following firms:

Rank	Firm	Misconduct Rate
1	Oppenheimer & Co.	19.60%
2	First Allied Securities	17.72%
3	Wells Fargo Advisers FN	15.30%
4	UBS Financial Services	15.14%
5	Cetara Advisers	14.39%
6	Securities America	14.30%
7	National Planning Corporation	14.03%
8	Raymond James	13.74%
9	Stifel, Nicolaus & Co.	13.27%
10	Janney Montgomery Scott	13.27%

The above-listed firms constitute a pantheon of malfeasance.[6]

The Heart of Darkness

In his 2015 presidential address to the American Finance Association, Harvard professor L. Zingales remarks: "I fear that in the financial sector fraud has become a feature and not a bug."[7] This is not a

[5] 'Misconduct' is defined as a disciplinary event involving civil, criminal and regulatory actions, and disclosed investigations.

[6] On April 9, 2019, Joseph F. Ready, Executive Vice President of Wells Fargo Institutional Retirement & Trust announced: "We are committed to serving the needs of clients and their participants as they strive to build stronger futures. That is why we are especially excited today to announce that Wells Fargo has entered into an agreement to sell the institutional Retirement & Trust (IRT) business to Principal Financial Group. …This agreement includes the retirement plan administrative services (401K and pension), executive deferred compensation (non-qualified plans), institutional trust and custody, and institutional asset advisory businesses." Translation: Wells Fargo Bank's institutional clients woke up on April 9th to find that Wells had sold their account(s) to an insurance company!

[7] "Does Finance Benefit Society?" (January, 2015).

"few bad apples" problem. The great recession of 2008-2009 drew the curtain back on systematic conflicts of interest within the financial world. These problems still exist.

Consider this hypothesis:

> *Financial incentives may distort advice; many (though not all) advisers are paid in ways that encourage them to push certain funds. The quality of advice may also be constrained by the quality of advisers, who themselves may not be as knowledgeable in finance as necessary or expected. These effects are particularly strong if investors who are unable to make good portfolio decisions are equally unable to differentiate between bad, self-interested advice and good, independent advice.*

A study[8] tests these ideas, and concludes that financial advisers generally encourage investors to chase returns, invest in high-cost investment vehicles, and forgo a prudent level of diversification in favor of buying the next-big-thing in the investment world.

The study's conclusion motivates us to make some follow-on inquiries, the pursuit of which leads closer to the financial advice profession's heart of darkness:

1. Is the nature and quality of financial advice dependent on the adviser's personal compensation incentives?
2. How can an investor distinguish between biased, self-serving advice and independent, objective advice?
3. Is financial advice generally useful? Harmful?

Some, but not all, academic investigations suggest that compensation arrangements lead to billions of dollars in investor payments for high cost investment products.[9] The net result, to use a bit of jargon, is a decrease in investor 'welfare.' This means that the adviser is more likely to benefit from the advice than is the investor who follows it.

This happens because, in the words of one commentator, most financial advice is "product-centric:"

> *Financial planning was birthed in a world of selling insurance, investment products and, at the time, tax shelters. The core topic areas for the CFP [Certified Financial Planner] designation are based on a job task analysis of what planners do – which in turn is based on what planners sell in order to get paid.*[10]

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[8] "The Market for Financial Advice: An Audit Study (April, 2011). The authors of the study are faculty members at Harvard, MIT and University of Hamburg in Germany.

[9] "Fact Sheet: Middle Class Economics: Strengthening Retirement Security by Cracking Down on Backdoor Payments and Hidden Fees," February 23, 2015, https://www.whitehouse.gov/the-press-office/2015/02/23/fact-sheet-middle-class-economics-strengthening-retirement-security-crac. This study indicates that hidden costs levied by the retirement savings industry cost Americans approximately $17 billion per year.

[10] http://www.financial-planning.com/news/industry/kitces-does-planning-software-go-too-far-or-not-far-enough

Planning under these conditions becomes a product rather than a process. However, some investors might prefer this approach because real planning requires (expensive) time, thought, and effort, whereas a product requires only a check. It's sometimes easier to buy than to plan.

Complex econometric modeling of contracting between sophisticated financial firms and less-sophisticated investors suggests that investors tolerate suboptimal economic results ("disutility") if they benefit (e.g., save time) by buying products which appear to offer turn-key solutions. Furthermore, advisory firms are motivated to lower investor welfare up to the point where either:

- The liability costs for inflicting disutility (e.g., for fraud and misrepresentation) exceed the extra profits earned by promoting "incentivized products" to investors; or,
- Where the advisory firm suffers reputational damage that inhibits its ability to earn adequate future revenue.[11]

Whenever the investor does not realize (or care) that the adviser is encouraged to provide biased advice, the probability increases that adviser will steer the discussion towards more remunerative products. This is an interesting two-way dynamic because only efficient product providers can afford to pay high commissions and remain in business. By steering clients to high commission products, so goes the argument, the adviser may be enhancing general public welfare by helping allocate resources efficiently. You gotta love economists![12]

Credence Goods

The above discussion highlights the fact that financial advice is a 'credence good.' Credence goods arise whenever the seller has a significant informational advantage over the buyer ("information asymmetry"). There is an extensive body of literature built up around credence goods; indeed a famous 1970 article by Nobel Prize winner George Akerlof[13] points out that cars, only a few months old, sell for drastically reduced prices because potential buyers are wary that the seller wants to get rid of a mechanically defective car. The buyer wants information that the seller may be reluctant to disclose; therefore, the buyer, fearing that he will be hornswoggled, refuses to offer the full or justified price even for cars in good shape. This, in turn, means that owners of truly road-worthy cars, who are reluctant to accept unfairly low prices, are reticent to bring their vehicles to market. Fewer high-quality cars are available for purchase – reinforcing the buyer's skepticism concerning all car sellers.

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[11] "How (not) to pay for advice: A framework for consumer financial protection," The Journal of Financial Economics (August, 2012). The article cites a US Department of Treasury (June 2009) report: "Impartial advice represents one of the most important financial services consumers can receive … When these intermediaries accept side payments from product providers, they can compromise their ability to be impartial. Consumers, however, may retain faith that the intermediary is working for them and placing their interests above his or her own, even if the conflict of interest is disclosed. Accordingly, in some cases consumers may reasonably but mistakenly rely on advice from conflicted intermediaries."

[12] A recent working paper by Stanford University professor Jonathan Berk and University of Pennsylvania professor Jules van Binsbergen ("Regulation of Charlatans in High-Skill Professions") argues: "Professions with weak trade groups, skills in larger supply, shorter training periods and less informative signals regarding the professional's skill, are more likely to feature charlatans."

[13] "The Market for Lemons" The Quarterly Journal of Economics (August 1970).

Here's the key point: in the absence of an ability to judge the quality of a good, a buyer is inclined to go cheap. Quality disappears from the marketplace and general public welfare decreases. Some would offer the opinion that the current market for financial advice is, in fact, a market for lemons.

A good example of a credence good is medical care.[14] How do you find a good doctor or dentist? Medical services are next to impossible for a layperson to assess either before or after their delivery. Hence the value of trust and comfort: "my doctor listens and has a wonderful bedside manner." Without a deep knowledge of the profession, it is most difficult to evaluate medical/dental procedures to determine the level of practitioner skill – as opposed to social prominence. Same with financial advisors: "I have a wonderful advisor – he's on the board of several local charities and non-profit organizations."

Or, you could just go cheap. You want cheap? Go find a robo-advisor on the internet. If you can't tell the difference between an investment portfolio spit out by an algorithm and a prudent portfolio exhibiting care, skill, and caution, you might as well save some money, time, and aggravation.

Advice or Schmooze?

Not surprisingly, the financial product and services industry, as well as some academic studies, offer a different perspective on the value of investment advice. As one article points out, studies commissioned by the financial series industry "… consistently observe that those who seek advice are also those who are financially better off."[15] Although industry-sponsored research tends to confirm the value of advisers, some independent studies also confirm the value of financial advice. For example, an objective study of Canadian consumers tends to support industry arguments. It finds:

- Participants retaining the services of a financial adviser for more than 15 years have 2.73 times the level of assets than those not working with an adviser;
- The impact of advice increases with the tenure of the advice; and,
- The presence of an adviser increases investor confidence in the ability to attain an economically secure retirement.

It's a chicken/egg question as to whether advisers are good at finding wealthy clients or clients become wealthy because they work with advisers. Many advisers have conflicting incentives in that they must sell products to survive economically. The population group best able to buy such products is wealthier investors. However, advisers need to offer recommendations that enhance client welfare if they hope to build legitimate and long-lasting practices. Surveys indicate that households retaining advisers tend to have higher savings rates and greater allocations to non-cash financial instruments. They are likely to report a high level of trust, confidence, and satisfaction with their advisor. Financial advisers correctly point out that they often serve clients by "quarterbacking" complex planning with legal and accounting advisers; and, that they often provide a counseling/mediating service to prevent clients from succumbing to fear or greed. In fact, there is more than a little evidence to suggest that one of the more

[14] We also include services provided by attorneys, accountants, electricians, mechanics, plumbers, and most of all, computer consultants in this list.
[15] "Econometric Models on the Value of Advice of a Financial Advisor," Montreal (July 2012) Centre interuniversitaire de recherché en analyse des organisations.

valuable functions of financial advisers is to stop clients from shooting themselves in the foot during times of market volatility or personal/family turbulence.

Intangibles such as mitigating the likelihood of emotionally motivated action, increasing investor confidence, and engendering peace of mind are difficult to measure. Cynics might be tempted to point out that the primary value of the investment advisory profession lies in its ability to offer schmooze.[16] This is the tenor of a study of over 32,000 randomly selected investor accounts at a large discount German brokerage firm. Investor accounts are designated either as self-managed, or as accounts run by or in consultation with independent financial advisers.[17] After comparing adviser-run accounts with self-managed accounts, the authors point out:

> *In econometric analysis that controls for client demographics and experience … [financial advisers] are seen to lower total and excess returns, raise portfolio risk (systematic and unsystematic), increase the probabilities of losses and of substantial losses, and increase trading frequency and portfolio turnover … Regression analysis of who delegates portfolio decisions suggests that advisors are matched with richer, older investors rather than with poorer, younger ones. In this respect, they are similar to babysitters: they are matched with well-to-do households, they perform a service that parents themselves could do better, they charge for it, but observed child achievement is often better than what people without babysitters obtain."*

Whew: tell us what you really think! If you're wealthy, you're likely to hire a financial adviser; but, does hiring an adviser make you wealthy?[18]

Agency Costs

Much of modern society relies on a "Principal-Agent" framework. A principal [investor] hires an agent [financial adviser] because the agent has a comparative advantage in areas important to the principal's wellbeing. However, for a variety of reasons, the goals and incentives of the principal may differ from those of the agent. The principal runs the risk that the agent, especially in circumstances where the agent has broad discretion in an environment that is informationally opaque [think hedge funds / separately managed accounts / private equity deals][19] will fail to represent the principal's interests. When the underlying agent compensation structure is not consistent with (1) the tasks the principal

[16] In fact, this is the conclusion of the Brookings Institute study cited earlier.

[17] "Financial Advisors: A Case of Babysitters?" Working Paper March 15, 2009.

[18] The data used in this study are mirrored in a 2012 report on participant accounts in Oregon University's Retirement Program. Participating investors using brokers underperform those not using brokers by more than 1.5% per year. *What is the impact of financial advisors on retirement portfolio choices and outcomes?* NBER Working Paper 18158, by J. Chalmers and J. Reuter.

[19] "With the 'right' fee structure mediocre investment managers many become rich as they ensure that their investors cease to remain so." M. Wolf, "Why Today's Hedge Fund Industry May Not Survive," *Financial Times*, March 18, 2008.

wishes the agent to perform, or, (2) the goals the principal wishes to attain, the principal is likely to suffer 'agency costs.'[20]

Agency costs are not necessarily quantifiable in dollars and cents. Suppose that the wealth of a portfolio manager depends on the amount of money that investors commit to his portfolio. If investors evaluate the manager based on his investment track record, he is motivated to crank up risk in hopes that his portfolio will win the rate-of-return / track record tournament. The agency costs arise because the portfolio manager's risk preferences differ from those of his customers. This means that the agent may employ tools and techniques of portfolio management (e.g., leverage and financial derivatives) that, if adequately disclosed to the investor, might not be acceptable. A winning track record can hide a lot of chicanery.

Here's the main point: the financial adviser's compensation structure directly shapes his or her economic incentives with respect to the objectives of the principal. Whenever the adviser receives compensation from sources other than the principal, there is an increased likelihood that the principal will suffer agency costs.[21] In the above example, agency costs are measured by the extent to which the portfolio manager's risk preferences differ from the investor's. In other examples, agency costs can be quantified in terms of cold, hard cash. Evidence suggests that most investors do not realize the magnitude of such hidden costs.

A Brief Tour through the Financial Adviser Zoo

There are many kinds of financial advisers, with widely different levels of technical expertise and professional reputation, including:

- Technical experts such as estate and trust attorneys or accountants;
- Investment advisors;
- Generalists who advise on personal budgeting, estate planning, insurance and investment issues – financial planners, wealth consultants, and the like;
- Counselors working to help clients in crisis situations (bankruptcy, divorce, credit counseling, etc.);
- Specialists such as mortgage brokers, insurance brokers, bankers, enrolled agents, etc.
- Financial or life coaches, who stress motivational techniques such as positive reinforcement and self-control in the pursuit of financial goals.

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[20] As Columbia Business School professor, Andrew Ang, puts it in his 2014 book entitled *Asset Management*: "Agency problems in delegated asset management arise because the asset owner (principal) and the fund manager (agent) have different utilities or risk aversions, incentives, horizons, skills, information sets, or interests."

[21] A list of compensation sources and compensation arrangements that are likely to trigger agency costs forms the subject of a presentation by Chester S. Spatt, Chief Economist and director of the Office of Economic Analysis at the SEC: "Conflicts of Interest in Asset Management," May 12, 2005. The list, which predates the 2008 financial crisis, enumerates many arrangements which, sad to say, remain legal in today's marketplace. Spatt notes that " … the existence of natural conflicts in incentives does not necessarily imply a breach of duty or responsibility by the agent or 'wrongdoing' … " However, many conflicts of interest may be mitigated "by limiting needless 'discretion' and articulating to everyone in a transparent fashion … "

If you include stock brokers, real estate and insurance agents, the Bureau of Labor Statistics data suggest that there are over 1 million "financial advisers" in the U.S., excluding attorneys and CPAs. There are well over 100 professional designations and credentials in use today. Many of them, according to the *Wall Street Journal*, " … can be earned with minimal or no study and a few hundred dollars."[22]

There are a lot of phony "experts" looking to get between you and your money. For example, how would you like to consult with a W.M.S. – Wealth Management Specialist? According to the *Wall Street Journal*, a W.M.S. designation is the product of a self-study course with no continuing education requirements. How about a Certified Senior Advisor? This designation, according to CNN Money research, " … merely indicates that the 'expert' studied how to communicate with (and market to) seniors." Is it better to have the C.R.F.A. degree? According to CNN Money, "Earning the 'Certified Retirement Financial Adviser' credential does involve financial training, but it's a self-study or four-day course and only requires passing a 100-question multiple-choice exam."

Here's a test question: Advisers holding a 'Certified Senior Advisor' degree are (a) highly skilled; (b) unlikely to try to push annuities and other high-commission products; (c) probably not employed by a sales-oriented company; or (d) none of the above?

How do you select a financial adviser? There are hundreds of advice articles on this question. Usually they take the form of "The six things you should know before signing up an adviser," or, "The ten questions to ask an adviser." The best advice available is the Securities and Exchange Commission's paper "*Investment Advisers: What you Need to Know Before Choosing One."* This paper is written for a general audience and may be found on the SEC's website.

Prudent investing advice encompasses a standard of competence as well as a standard of conduct. Most credentials exist only to paint a veneer of respectability on incompetent and unqualified advisers.

Fee-Based versus Fee-Only

The distinction between fee-based and fee-only is a crucial element in locating an adviser who limits the potential for conflicts of interest. As an added bonus, skilled practitioners are most likely to be found in the 'fee-only' segment of the profession. These are the advisers whose compensation does not include sales commissions or other forms of hidden compensation (e.g., "soft dollar" compensation, payment for directed trade order flow, etc.); their income is a function of advisory fees paid directly to their firms by clients.

So called 'fee-based' advisers can generate income from fees *and* from commissions. The College for Financial Planning, for example, identifies fee-based Certified Financial Planners [CFPs] as those earning between 50 and 90 percent of income from fees. This leaves substantial room for commission earnings. In short, a fee-based adviser can charge fees and commissions; a fee-only adviser charges only fees.

[22] *WSJ Online* October 16, 2010: "Is Your Adviser Pumping Up His Credentials?"

An investor first should determine that an adviser's income does not come from sales commissions or production bonuses. Preferably, the investor should also confirm that the firm that employs the adviser does not receive any compensation from product or service vendors, but this information is much more difficult to ascertain.

Are there ways in which fee-only advisers can abuse their clients? Yes – but the opportunities for bad behavior are more limited, especially if the adviser does not take discretionary authority over your assets. If you work with a fee-only adviser, there is no guarantee that you have located a good adviser, but your odds of doing so are much better than if you had done otherwise. The label 'fee-based' is often a code term for a product salesperson.

Registered Investment Advisers, Fiduciaries, and Investment Costs

Investors are sometimes confused about differences in practice standards among various types of practitioners. Unfortunately, the next few paragraphs introduce some rather dry legal concepts. However, not knowing the lay of the land can, as we will illustrate, cost you many thousands of dollars.

Broker-Dealer firms, employing 'stockbrokers' or 'registered representatives,' are regulated under the Securities Exchange Act of 1934. The Financial Industry Regulatory Authority [FINRA] – a self-regulatory organization – imposes rules for broker-dealers and their employees and agents. Generally, state law specifies that registered representatives must meet a "suitability standard." This standard permits a broker to recommend "suitable" products that may advantage the broker because they have higher commissions than other products in the marketplace. Furthermore, the broker is not under any obligation to inform the investor about non-product-related solutions. As one recent study[23] states:

> *A suitability constraint allows brokers to recommend products that are not necessarily in the best interest of the client but may be considered potentially suitable given the customer's characteristics and needs. This latitude in product recommendation among registered representatives provides a greater opportunity to extract customer rents [i.e., agency costs] than would be possible under the constraints of a fiduciary standard …*

Things get more complicated in California because it imposes a fiduciary standard on broker-dealers operating in the state.[24] Thus a stockbroker, as an employee of a broker-dealer, owes a duty to his employer as well as a duty to his customer. This may create uneasy relationships. A broker-dealer often acts as counterparty to its customers by selling securities from its own inventory. An RIA, by contrast, does not [at least should not!] place himself in such potentially adversarial relationships. More about this below.

Registered Investment Advisers [RIAs] that meet a threshold of assets under management are regulated by the SEC under the Investment Advisers Act of 1940 (smaller RIAs are regulated by state securities

[23] "The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice," Michael Finke and Thomas Langdon http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2019090

[24] You may have noticed that there are few 'stockbrokers' in California – they're all 'wealth advisors' or 'financial consultants.'

regulators). Generally, the 1940 Act provides that the adviser must act as a fiduciary which, according to the SEC, means that the adviser must seek to avoid conflicts of interest with his or her clients, and to disclose to them such conflicts of interest as may then remain. The following is a short-form definition of a fiduciary: "A fiduciary is a financial advisor who has a legal and regulatory duty to put your interests ahead of his or her own."[25]

Generally, an adviser [RIA] operating under the 1940 Act provisions must adhere to a federal fiduciary standard. The Supreme Court, interpreting the antifraud provisions of the 1940 Act in a seminal case (*SEC v. Capital Gains Research Bureau*), concluded that advisers must adhere to a strict fiduciary standard including a duty of utmost good faith, full and fair disclosure of all material facts, and an obligation to use reasonable care to avoid misleading clients.[26] The Court describes the basic function of an adviser as "furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments … "

Does this make a dime's worth of difference to anyone? Consider the following hypothetical:

Example One: Stockbroker

A stockbroker ("wealth consultant") recommends that a retirement income client invest $1 million in an annuity paying a 7% up front commission, and $2 million in a portfolio of bonds, real estate master limited partnerships, and structured notes paying an average of 3% commission. The net result is an immediate, *and often undisclosed*, payment to the broker of $130,000. Plus, assuming that the variable annuity / portfolio combination incurs an annual expense ratio of 2.5%, this extracts another $75,000 each year, directly from client wealth.

Example Two: An RIA

An RIA ("Registered Investment Adviser") recommends that the same retirement income client invest in a balanced portfolio of globally diversified, no-load, low fee mutual funds. The initial $3 million investment incurs an annual expense charge (portfolio expense ratio) of 0.37% and a direct payment to the advisor for ongoing portfolio monitoring and supervision services of 0.75% for an aggregate cost of 1.12%.[27] If the direct payment to the adviser is made on a semi-annual basis, the immediate, *fully disclosed*, payment to the advisor is $11,250, plus another $33,600 (for an advisor fee and fund expenses) payable annually by the client.

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[25] *The Index Card: Why Personal Finance Doesn't Have To Be Complicated*. Helaine Olen and Harold Pollack (2016).

[26] If you would like a more detailed discussion regarding the nature of fiduciary duties, state statutes and regulations regarding RIAs and broker-dealers, and the differing standards ("suitability" v. "fiduciary") applicable to various segments of the financial advice community, we recommend the 2010 *Villanova Law Review* article, "Fiduciary Obligations of Broker-Dealers and Investment Advisers" by Arthur B. Laby.

[27] Costs are based on a 2015 internal survey of Schultz Collins clients. Average aggregate portfolio expense ratios equal 37 basis points. Fee schedules vary depending on the number of accounts and their administrative complexity. A single non-qualified account at a $3 million asset level incurs an approximately 75 basis points [0.37% where 1.00% equals 100 basis points], assuming a "typical" scope of services. A number of factors may cause dispersion in both numbers.

The disclosed cost in example one is $0.00 (we assume that the broker will not rush to point out the prospectus disclosures surrounding annual expense charges). The disclosed cost in example two is $33,600. Broker costs are onerous but usually opaque; advisor costs are modest but highly visible. The broker, in this example, operates opportunistically; but remains within the client suitability standard. Although there is nothing illegal going on here, the fact pattern is a good example of agency costs. An unsophisticated client may believe that he is implementing the Stockbroker portfolio for free!

"Opportunistic Behaviors" & Hybrid Practice Models

It is a short – but *unwarranted* – leap of logic to assume that either the California stockbroker or the RIA will, in fact, provide conflict-free services, at a level of care skill and caution demanded from a fiduciary. In fact, it is in the first place almost impossible to eliminate every conceivable conflict of interest, and in the second place quite a few firms don't try very hard to do so. This is sometimes surprising to investors who assume that designations such as "registered investment adviser" or "independent registered investment adviser" are synonymous with a strict adherence to fiduciary principles. Investors must, unfortunately, look beyond the designation to determine the extent to which their adviser acts in a fiduciary capacity.

Although of concern to all investors, these topics are of particular importance to investors acting as trustees.[28] "Opportunistic behaviors" in the fiduciary accounts of banks, brokerage firms, and other institutions are often disclosed in investment advisory agreements drafted by their legal departments. Sad to say, a primary purpose of such investment advisory agreements may be to allow the financial firm to contract out of certain fiduciary duties. If, as a condition of receiving investment advice, such an agreement is reviewed and signed by a trustee, some legal commentators suggest that the parties have agreed not to apply certain provisions of the default standards for prudent asset management embodied in state prudent investor statutes or other relevant law. Disclosure of conflicts of interest in the fine print of an advisory agreement, rather than avoidance of conflicts of interest, is a commonly used technique to water down – or, some would argue, to gut – reasonable standards of fiduciary practice. *Caveat Investor*.

A common business model is the "hybrid practice model." This term refers to firms dually registered as both Registered Investment Advisors regulated under the 1940 Act, and as broker-dealers under the Securities and Exchange Act of 1934. Representatives of dual-registered firms sell investment advisory services as fiduciaries, and sell securities as registered representatives of a stock brokerage firm. The 1940 Act demands a fiduciary standard of care – unless the advisory firm contracts out of it through client execution of an investment advisory agreement indicating client acceptance of certain disclosed practices.

Needless to say, the terminology becomes very confusing. Investors must distinguish among services offered by an independent RIA, an Independent Broker-Dealer, a Corporate RIA, a Registered Representative, a Registered Investment Advisor, and an Independent Investment Counsel. Some of these designations imply a fiduciary standard of care, others a lesser standard of care. The same adviser

[28] Investors responsible for investing funds for the benefit of others.

may switch hats in the middle of an engagement in order to provide "full service." For example, asset allocation modeling might be done under the auspices of a Corporate RIA structure while portfolio implementation might occur under standards applicable to registered representatives – i.e., stockbrokers.

Do You Need an Adviser?

The intelligent consumer must decide what they need and what they are willing to pay for it. Perhaps you are familiar with the book *The Index Card: Why Personal Finance Doesn't Have To Be Complicated* by Helaine Olen and Harold Pollack.[29] Here are some thought-provoking excerpts:

> *All too many people working in the financial services industry market themselves as our friends who have special insights into the world of finance and future events … There is a whole industry of financial services advisors out there who make their living by convincing you that it's naïve to believe that simplicity, common sense, and restraint are potent enough weapons with which to deal with the whirlwind of financial chaos facing any of us on any given day. They make their money by convincing you that investing is so complicated, you need to turn it over to them. Or they convince you that they – as insiders, as 'professionals' – have the ability to outsmart everyone else and know exactly what investment scheme will outperform the S&P 500.*
>
> *Very few of us have any idea of how much we are paying for financial advice. According to a 2011 survey … one-third of us thought we were receiving a free service when we turned to a broker for financial advice. Another third admitted to absolute befuddlement about how someone would be compensated for investment strategies … .it is not in the interests of almost anyone doling out financial advice for you to realize how much his counsel is going to cost – or that it is going to cost you anything at all.*

To put the above quotations in perspective, the Index Card primarily focuses on developing a few simple rules to help people deal with credit card debt, personal savings, participating in a 401(k), acquiring insurance, and buying a home. The premise of the book is that there are a few simple financial planning rules that fit on a 4'' by 6'' index card:

- Strive to save 10 to 20 percent of your income
- Pay your credit card balance in full every month
- Max out your 401(k)
- Never buy or sell individual stocks
- Buy inexpensive, well-diversified indexed funds
- Make your financial advisor commit to the fiduciary standard
- Buy a home when you're financially ready
- Make sure you have adequate insurance
- Do what you can to support the social safety net.

[29] We are big fans of Helaine Olen. You can find a discussion of her last book: *Pound Foolish* on our website at http://schultzcollins.com/resource/pound-foolish/

For individuals whose financial situation extends beyond the basics, the book recommends securing the services of a financial advisor: "If you want unconflicted financial advice, you almost certainly have to pay for it."

As a supplement to the Index Card approach to financial planning, we call your attention to three noteworthy quotations:

> *It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it.*
>
> - *Ralph Waldo Emerson*

> *Make everything as simple as possible, but not simpler.*
>
> - *Albert Einstein*

> *When all is said and done, we doubt that an industry that has added little if any value can continue to exist in its present form.*
>
> - *Brookings Institute: The Structure and Performance of the Money Management Industry.*

We agree with all three sentiments. Unfortunately, the Brookings Institute study's prediction did not pan out – yet.

Making Advice Work for the Client

The great recession of 2008 – 2009 was a watershed moment for the financial industry. Clients in under-diversified portfolios experienced substantial economic setbacks. Given the NASDAQ tech-stock meltdown in 2001 and the global recession of 2008-2009, an all "blue chip" stock portfolio like the S&P 500 had an approximately zero percent rate of return over the period January 2000 through December 2011. This is a twelve year period in which the investor failed to receive any compensation for investment risk. Fortunately, the market prediction industry that supported a host of investment gurus also suffered a well-deserved credibility setback.

These harsh realities had some salutary effects on the financial advice profession. Financial decision making began to be evaluated on new and more reasonable metrics. The siren song of "work with me and I'll make you rich," gave way, in some cases, to "work with me and I'll help you discover appropriate strategies to facilitate attainment of financial objectives." Planning moved from an exclusive focus on the left-hand side of the balance sheet (assets only) to a more integrated asset/liability type of asset allocation and portfolio management approach.[30]

[30] For a detailed analysis see: Patrick J. Collins "How to Deal with Changing Realities in Asset Allocation: Fiduciary Liability in Turbulent Economic Times," ACTEC-ALI course materials (November 8, 2012), pp. 83-165. http://schultzcollins.com/static/uploads/2016/02/How-to-Deal-with-Changing-Realities-in-Asset-Allocation-presentation-to-ACTEC-ALI.pdf.

The evaluation metrics shift from how much money you made to what was the value of the planning solutions that you adopted and implemented. It is cold comfort to find that you beat the S&P 500 when it was down 57% from peak to trough.

Schultz Collins pioneered interactive investment planning techniques that allow investors to "test drive" investment ideas prior to their implementation. Clients can look before they leap. The firm developed advanced modeling expertise and communicated it to the profession in a series of publications.[31] Intelligent planning enhances the likelihood of financial success, if for no other reason, than that it allows for an in-depth discovery and evaluation of planning options. The question of how to plan takes precedence over the question of what to buy.

Enter the DOL

The U.S. Department of Labor [DOL] has long protected the interests of participants and beneficiaries in tax-qualified retirement plans (e.g., corporate-sponsored Pensions, Profit Sharing, and 401(k) plans) through its enforcement of the Employee Retirement Income Security Act [ERISA] and its accompanying regulatory provisions.[32] Effective April 2017, DOL announced: (1) new investment advice safeguards for retirement plans; and (2) extension of the new protections to IRAs. The DOL advances the following rationale for these steps:

> *… professional advisers often are compensated in ways that create conflicts of interest, which can bias the investment advice that some render and erode plan and IRA investment results."[33] Specifically, "Plan participants and IRA owners often lack investment expertise and must rely on experts – but are unable to assess the quality of the expert's advice or guard against conflicts of interest. Most have no idea how advisers are compensated for selling them products. Most are bewildered by complex choices that require substantial financial expertise and welcome advice that appears to be free, without knowing that the adviser is compensated through indirect third-party payments creating conflicts of interest or that opaque fees over the life of the investment will reduce their returns.*

The DOL estimates "an ERISA plan investor who rolls her retirement savings into an IRA could lose 6 to 12 and possibly as much as 23 percent of the value of her savings over 30 years of retirement by accepting advice from a conflicted financial adviser...the balance of research and evidence indicates the

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[31] See, for example: Patrick J. Collins, Huy Lam, and Josh Stampfli, "How Risky is Your Retirement Income Risk Model?" Financial Services Review, (Fall, 2015), pp. 193 – 216.
http://schultzcollins.com/static/uploads/2015/01/How-Risky-is-Your-Retirement-Income-Risk-Model1.pdf

[32] The U.S. Department of Treasury, primarily through Internal Revenue Code section 4975, supplements ERISA's protection provisions by detailing a series of prohibited transactions with respect to dealing with tax-qualified plans. Prohibited transactions encompass self-dealing and conflicted transactions involving plan fiduciaries. Violations of the prohibited transaction rules may result in excise tax penalties under the Revenue Code and civil penalties under ERISA.

[33] The Federal Register April 8, 2016: "Definition of the Term 'Fiduciary'; Conflict of Interest Rule-Retirement Investment Advice" p. 10. Much of the following discussion will be based on the April 8th Federal Register [FR].

aggregate harm from the cases in which consumers receive bad advice based on conflicts of interest is large."[34]

The DOL remedies for this abusive situation are:

1. Imposition of a fiduciary standard of conduct to those rendering "investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan … ." and,
2. Prohibition from engaging in "prohibited transactions, which pose special dangers to the security of retirement, health, and other benefit plans because of fiduciaries' conflicts of interest with respect to the transactions."[35]

The DOL stresses that the new provisions are vital for the protection of 401(k) and IRA investors because "… adviser conflicts are inflicting large, avoidable losses on retirement investors … ."[36]

ERISA and Revenue Code provisions governing fiduciaries have teeth; and individuals and financial firms providing investment advice to retirement plans and IRAs are now deemed to be fiduciaries with respect to plans and IRAs: " … any person who renders investment advice for a fee or other compensation, direct or indirect is an investment advice fiduciary, regardless of whether they have direct control over the plan's assets, and regardless of their status as an investment adviser or broker under the federal securities laws." [37]

The Federal Register devotes approximately 100 pages to defining various fiduciary obligations, providing examples, discussing what activities are covered by the act's extension of fiduciary status, and so forth. For example, a central focus of DOL's new regulations is on advisor recommendations regarding whether to roll funds out of a corporate-sponsored plan into an IRA: "… the advisor also could not recommend that a plan participant roll money out of a plan into investments that generate a fee for the adviser, but leave the participant in a worse position than if he had left the money in the plan." Unfortunately, this type of conflicted advice is endemic in the industry; more than a few advisory firms operate on business models designed to promote this abusive practice. With luck, the extension of DOL regulations to IRAs will curtail such activities: "… advisers who claim fiduciary status under ERISA or the [Revenue] Code are required to honor their words. They may not say they are acting as fiduciaries and later argue that the advice was not fiduciary in nature."[38] Best of all, the practice of using investment advisory agreements as vehicles to contract out of fiduciary duties will be severely curtailed:

> *… advisers should not be able to specifically direct investment recommendations to individual persons, but then deny fiduciary responsibility on the basis that they did not, in fact, consider the advice recipient's individual needs or intend that the recipient base investment decisions on their recommendations. Nor should they be able to continue the practice of advertising advice or*

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[34] FR, p. 11.
[35] FR, p. 4.
[36] FR, p. 17.
[37] FR, p. 22.
[38] FR, p. 54.

counseling that is one-on-one or tailored to the investor's individual needs and then use boilerplate language to disclaim that the investment recommendations are fiduciary investment advice.[39]

Generally, it is fair to assert that a wide swath of the financial products and service industry bitterly opposed (and continues to lobby for repeal of) the new regulations. A particular point of contention is the extension of the new rules to IRAs. Although there are certain exemptions, the purpose of prohibited transaction rules is to prevent a fiduciary from personally profiting from transactions with retirement plans. Not surprisingly, lawyers, actuaries, accountants and others provide services that are usually deemed not to violate the prohibited transaction rules. However, the designation of brokers, fee-based advisers, and insurance agents as fiduciaries when dealing with IRA owners seems to threaten the variable (product based) commission income. Prohibited transaction rules bar fiduciary advisors from receiving such 'variable compensation,' where variable compensation is remuneration that varies on the basis of products in which the plan or IRA account invests.

Does this mean that brokers, fee-based advisors, and insurance agents must forsake product-based compensation arrangements? We hope you already know the answer – there is also a new exemption from the prohibited transaction rules. The Best Interest Contract Exemption [BICE] permits the continued receipt of such compensation. The new exemption advances three elements required to meet a Best Interest Standard:

1. Recommendations must be 'Prudent';
2. Recommendations must be based on a client's investment objectives, risk tolerance and financial needs and circumstances; and,
3. Recommendations must be made without regard to the advisor's interests.

The DOL expects that "… retirement investors should be protected by a more consistent application of fundamental fiduciary standards across a wide range of investment products and advice relationships, and that retail investors, in particular, should be protected by the stringent protections set forth in the Best Interest Contract Exemption."

It is noteworthy that the Schultz Collins business model, described below in greater detail, passes muster with the DOL:

> *The Department believes that, by itself, the ongoing receipt of compensation calculated as a fixed percentage of the value of a customer's assets under management, where such values are determined by readily available independent sources or independent valuations, typically would not raise prohibited transaction concerns for the adviser. Under these circumstances, the amount of compensation received depends solely on the value of the investments in a client account, and ordinarily the interests of the adviser in making prudent investment recommendations, which*

[39] FR, p. 56. We note with some amusement that the DOL rules exempt radio and TV personalities who tout certain stock transactions or investment strategies. The DOL provides the following rationale for this exemption: " … the Department does not believe that a reasonable person could fairly conclude that such communications constitute actionable investment advice … "

could have an effect on compensation received, are consistent with the investor's interests in growing and protecting account investments.[40]

The critical distinction is that, in the variable income model, the adviser/broker/insurance agent receives compensation based on the number of transactions processed or the specific products bought and sold within the plan or IRA. Under the level fee income model a level fee (or, fee based on a predetermined fee schedule based on the value of the assets in the account) determines adviser income. The fee does not vary with product selection and does not fall under the purview of prohibited transaction rules because the adviser cannot use his fiduciary position to influence his compensation.

Exit the DOL; Enter the SEC (Securities and Exchange Commission)

On March 15, 2018, the U.S. Fifth Circuit Court of Appeals vacated *in toto* the DOL Fiduciary Rule.[41] The court's decision applies also to the Best Interest Contract Exemption Rule. The ruling is based, in part, on the arguments that the Fiduciary Rule and its accompanying exemptions fail to meet the "reasonableness" requirements of the U.S. Administrative Procedures Act; unnecessarily infringe on "SEC turf;" and undermine specific provisions of the Dodd-Frank legislation which do not prohibit commission-based compensation. The DOL announced that it will not seek a rehearing and will not appeal to the U.S. Supreme Court.

In April of 2018, the SEC proposed a controversial 408 page set of conduct standards and disclosure requirements.[42] The "Regulation: Best Interest" section of the proposal will "raise the standard for broker/dealers to make it clear that they have to keep customer interests first when serving retail clients." Additionally, the proposal recasts the fiduciary standard under the Advisers Act, "in order to reaffirm and clarify the SEC's views on the standards of conduct applicable to investment advisers, who are fiduciaries."

Although, in general, the financial products and services industry praises the proposal, many supporters of the DOL's Fiduciary Rule are disappointed. The harshest criticism appears to be directed at the SEC's alleged attempt to "harmonize" standards for the broker-dealer sales community (currently under the self-governing regulation of FINRA – the Financial Industry Regulatory Association) with the 'stricter' fiduciary standards governing Registered Investment Advisers. One potential sticking point is that the FINRA definition of 'best interest" differs from the DOL's definition. FINRA advocates for a best interest standard based primarily on current broker-dealer suitability standards, but with enhanced disclosure of conflicts of interest. Some commentators assert that the SEC's goal, supported by FINRA, is nothing less than to gut the fiduciary standard protections as promulgated by the 1940 Investment Advisers' Act and subsequent judicial rulings thereon.

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[40] FR, p. 96.

[41] United States District Court for the Norther District of Texas Dallas Division: *U.S. Chamber of Commerce v. DOL* http://www.txnd.uscourts.gov/sites/default/files/documents/3-16cv1476Doc137.pdf

[42] Securities and Exchange Commission 17 CFR Part 240: https://www.sec.gov/rules/proposed/2018/34-83062.pdf

The Newly Emerging Landscape

During a recent speech (December 6, 2018), SEC Chairman Jay Clayton indicated that implementing the FINRA/SEC standards of practice is "a key priority."[43] An intellectual cornerstone of the proposed rules is the concept of "informed consent." If conflicts of interest are fully and clearly disclosed, the consumer's informed consent to proceed with the financial transaction should obviate the need for intrusive government regulations. The quick-witted reader may note that this is a variation on the theme discussed in the earlier section on Investment Advisory Contracts designed to allow advisors to contract out of critical fiduciary duties. Critics of the SEC proposals point out that putting such 'contractual weapons' into the hands of brokers who sell products is a perversion of a fiduciary standard that requires the fiduciary to represent the client's interest as opposed to the product manufacturer's interest. Under a fiduciary standard, when there is a possibility for a conflict to arise, fiduciaries owe it to the client not to subordinate the client's interests to their own. This obligation finds its source in the fundamental duty of loyalty which, because it is inherent in the office of fiduciary/trustee, cannot, under common law, be subject to client waiver. As one commentator remarks, it is difficult to envision a fully informed client agreeing to acquiesce to revenue sharing schemes (e.g., 12b-1 fees), soft dollar kickbacks to producers, marketing support payments, payments for directed order flow, combining broker agency transactions with dealer principal (e.g., underwriting) transactions, high pooled investment fees, or other methods of extracting customer wealth.[44] "While Regulation Best Interests encourages investors, by its very name, to fully trust their brokers, it does not impose any of the fiduciary duties upon brokers that would justify that trust."[45]

Currently, many insurance agents and stock brokers assert that designing and offering products capable of meeting fiduciary standards would inflict considerable harm on the small investor. It appears that their logic is somewhat tortured in that it begins with the assumption that manufacturers are unwilling or incapable of redesigning their suite of product offerings; hence, the small investor is left, for all time, with the Hobbesian choice of accepting a poorly priced product or nothing at all. Recently, for example, the Maryland General Assembly, following a parade of testimony by product-based advisors, postponed taking any action on a proposed Fiduciary Rule mandating that such advisors be held to a fiduciary standard.[46]

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[43] Text of speech found on the SEC website at: https://www.sec.gov/news/speech/speech-clayton-120618

[44] Can a principal authorize a fiduciary to act in bad faith?

[45] Ron A. Rhoades, "How SIFMA, FSI, FINRA and the SEC Conspired to Doom the Advisory Profession," Advisor Perspectives (March 18, 2019), p. 20. Ron Rhoades, JD, CFP is the director of the personal financial planning program at Western Kentucky University.

[46] Financial Consumer Protection Act of 2019 Senate Bill 786 http://mgaleg.maryland.gov/2019RS/bills/sb/sb0786f.pdf The testimony of Brian Jolles, a Baltimore insurance agent and financial advisor, regarding his 90-year-old former client is representative: "I made a promise to him at 76 when I was introduced to him by an estate planning attorney that I would help him with his goals. …In many cases it's commission products that are going to solve those needs. Because of my ability to offer those products and services, he died peacefully." *Res ipsa loquitur*. Indeed, it should be pointed out that when acting under a fiduciary standard, if a commission-based product is in a client's best interest, it should be a recommended solution. The Fiduciary Standards bill died in the Maryland Senate Finance Committee.

In modern commentaries both on trust law and on consumer rights and protection, advocacy for a contractarian rather than a fiduciary standard is becoming more widespread. It remains to be seen whether such a viewpoint is widely adopted by state and federal regulatory agencies. Whether advisors operating in such an environment will assume that adequate disclosure is tantamount to a hunting license is anyone's guess.

About Schultz Collins

Our ideal client is someone who is willing to become a partner with us in the decision making process. We see our role in the process as providing credible, insightful, and objective information so that a feasible solution path suggests itself to an intelligent client. We implement the client's preferred solution, monitor it, and let the client know whether it remains prudent and suitable. This process demands that we remain independent of any vendor of financial products and services – so that our only loyalty is to the client. We don't make money – or serve our clients well – by saying "well, here is what you should buy." We don't sell products, so our income does not depend on product sales.

Without doubt, you can obtain a very low – or even zero – explicit fee structure by going either to a broker-dealer advisory structure or to the retail side of a custodian's operations – Fidelity, Schwab, etc. Alternatively, you can obtain low/zero fees by going to a single source mutual fund company – Vanguard, T. Rowe Price, Fidelity, etc. But do not make the mistake of thinking that you will be saving money. The money will leak out of the portfolio in ways that are not visible.

The advisers at custodians and mutual funds, although often on salary, are evaluated and promoted, in large measure, by the amount of revenue they generate for their organizations. When such advisers recommend an investment product, is it really credible that they have the goal of keeping your investment costs down? If so, your opinion would surprise the SEC and a variety of other regulatory agencies, who systematically point out that retail customers get fleeced because they are unware of a formidable array of undisclosed fees, charges, expenses and costs. Schultz Collins has a vested interest in keeping investment product costs low. Schultz Collins puts you on the institutional side of the house and provides access to extremely low cost investment vehicles. Although other organizations may charge lower explicit fees, they are often a toxic environment for investors.

Of course, you can expect that the level of insight and analysis provided to you via an on-line or toll-free customer assistance line is several orders of magnitude lower than what we provide. Even simple details (like: what return did a portfolio earn and what level of risk did it incur?) often remain forever hidden from an investor's sight. Acting in the capacity as fiduciaries (rather than as product purveyors), we must adhere to a fiduciary standard of practice – one that encompasses a standard of competence as well as a standard of conduct.

Here is a return to and extension of the dry legal language that characterizes Schultz Collins:

SCI acts in the capacity of Independent Investment Counsel. The term Independent Investment Counsel derives from the 1940 Act. It signifies a Registered Investment Advisor with no formal contractual obligations or informal associations with Broker/Dealers, Banks, Custodians, or other elements of the financial services industry. The SEC defines investment counsel as, "an individual, institution,

organization, or department of an institution or organization which undertakes for a fee to advise or to supervise the investment of funds by, and on occasion to manage the investment accounts of, clients." The 1940 Act defines "investment counsel" as a subset of the "investment advisers" to whom the Act applies.

Perhaps the implications of this dry language are now clearer.

Twenty Reasons to Work with Schultz Collins

Here are things that we know and you should know them too:

1. Investment success is not about what to buy; rather, it is about how to plan.
2. The single greatest constraint on investment success is time. A little time productively spent today can save an ocean of time tomorrow. Failure to devote sufficient time to the investment enterprise often results in defaulting to high-cost, problematic, product-based solutions.
3. You need to learn critical information *before* you invest. Additionally, to enhance the likelihood of a successful outcome, asset management should adapt to changing circumstances *after* you invest. We don't tell you what to buy and then leave you alone.
4. We don't want to make you comfortable; we want to make you uncomfortable – by challenging you to reassess your investment goals and positions throughout changing economic conditions.
5. Our primary job is not to make you rich; our primary job is to help you avoid bad decisions.
6. We don't want you to like us as much as we want you to like what we do for you.
7. We don't work both sides of the street. We are not both "independent" investment advisors and employees of a broker-dealer firm. Our only client is you.
8. Markets go up and markets go down – you know this and we know this. You cannot earn returns in excess of the risk free rate without market fluctuations.
9. We welcome your economic viewpoints when considering future portfolio results. However, we don't let you fall into the trap of betting on single-perspective views about the economy, investment markets, stock picking, etc. If your insights were actionable, you wouldn't be hiring us – we would be hiring you.
10. If the first investment-related question that you ask is "what investments should I own?" you really need to hire us. Designing, implementing and managing an investment portfolio is a complex task. Without sufficient experience and expertise, it is difficult to evaluate, let alone identify, credible solution paths.

11. When faced with a complex task like designing and implementing an appropriate investment portfolio, the first solution you think of is often not the best. If you're not evaluating alternative solutions, you're not investing prudently.
12. We provide objective, independent investment advice tailored to your specific needs and circumstances for a fair price. If you are looking for objective, independent investment advice for a "bargain" price, you won't find it. This is the difference between Independent Investment Counsel and an Independent Investment Advisor. You get what you pay for.
13. Track record is "visible." It is an outcome that you can see. It is a result of an investment process that you cannot see. It is the process that's important – not the outcome. A poor process can have a lucky outcome; but poor decision making is unlikely to lead to long term success. A prudent decision-making process gives you the best chance of financial success.
14. A portfolio that is consistently invested 50% stock and 50% in bonds is much safer than a portfolio that is invested 100% in stocks 50% of the time and 100% in bonds 50% of the time. Relying on an advisor to keep you in stocks during prosperous times and in bonds during recessionary times produces fabulous results right up until the time that the advisor's predictions go wrong. It's probably a good idea to avoid strategies that can turn into land mines.
15. Investing is primarily about risk. You become a sophisticated investor when you realize that you can often generate more long term return by controlling risk than you can by grabbing investments with high expected payoffs.
16. Investing is also about time. Time does not mitigate risk – it merely provides more opportunities for things to go wrong. Time, however, allows you to employ strategies to solve your specific cash flow goals. If you define your investment goals in terms of "beating the market," go somewhere else.
17. Long term investors are, by definition, also short term investors. The long term is made up of a sequence of short terms. If things go wrong in the short term you need to think about how to adjust. You can't rely on the long term to bail you out. Investors require ongoing advice and consultation. We provide it.
18. SC has for many years consulted as an expert witness in litigation over investment disputes. We've seen many of the stupid, lazy or greedy things that people have done. We can help you avoid their mistakes.

19. What's the market going to do? This question is relevant only if you think that investment success depends on correctly forecasting the future. If you do indeed think that this is the case, find a fortune teller. A prudent process does not put you in the prediction business.
20. SC acknowledges its role as a fiduciary within the scope of the engagement for which it is hired. We do not accept discretionary accounts – we offer no 'blind-faith-and-blank-check' financial strategies. It's important that you know this. Almost all other financial firms take discretion of some sort over client accounts. We do not. We take no investment actions without your prior approval.

Patrick Collins

April, 2019

The information contained herein is not intended to be used as a general guide to investing, or as a source of any specific investment recommendations, and makes no implied or express recommendations concerning the manner in which any client's account should or would be handled, as appropriate investment strategies depend upon the client's investment objectives. It is the responsibility of any person or persons in possession of this material to inform themselves of and to take appropriate advice regarding any applicable legal requirements and any applicable taxation regulations that might be relevant to the subscription, purchase, holding, exchange, redemption or disposal of any investments.

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The portfolio risk management process includes an effort to monitor and manage risk, but does not imply low risk. Past performance is not indicative of future results, which may vary. The value of investments and the income derived from investments can go down as well as up. Future returns are not guaranteed, and a loss of principal may occur.

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