THE OPAQUE WEALTH MANAGEMENT INDUSTRY

WHERE CONSUMERS MUST NAVIGATE THROUGH MEANINGLESS DESIGNATIONS, HIGH FEES, AND POOR PORTFOLIO MANAGEMENT TO FIND THE RIGHT FIRM

By: Justin McNichols, CFA

After more than two decades at Osborne Partners, and as my next anniversary here approaches, I thought it would be both timely and educational to look back on the "wealth management" industry. Today, some characteristics of the industry are similar, but many are quite different. Regardless of the similarities and differences over the years, I have become increasingly passionate about educating people on this unique industry that has become increasingly opaque.

What do I mean by opaque?

Then Versus Now

When I joined Osborne Partners in 2000, there were approximately 6,600 RIAs (Registered Investment Advisers) in the country[1]. Most were quite small, but many were owned and managed by individuals who were trained in bank and trust company investment management departments. These firms mainly either managed portfolios of U.S. stocks and bonds or mutual funds. They would charge a management fee, offer some broad planning advice, try to stop you from panicking during bear markets, and generally control your capital gains (your annual tax bill). Pretty simple.

But today, with over 18,500 RIAs in the country[2], and such low hurdles in place to be called an RIA, the industry is not so simple. The investment industry presents a plethora of problems for high net-worth individuals trying to compare and contrast wealth management firms. These include:

Education and Experience

While a doctor is required to be an MD, an accountant is required to be a CPA, and a lawyer is required to pass the bar exam, the requirement to be a portfolio manager, investment advisor, analyst, or open an RIA is to simply have a clean criminal record. That is frightening.

The Chartered Financial Analyst (CFA®) charter is crucial to managing portfolios. The designation was first created in 1963 after financial analysts determined a code of conduct was necessary. The CFA® designation consists of three rigorous 4.5 hour exams (CFA Institute estimates that more than 300 hours of studying is needed to pass each exam), and 4,000 hours of work experience are required. The CFA® Charter is the most difficult designation to earn in the industry, which is why the majority of candidates fail to earn it. Fewer than 10% of advisors are CFA® Charterholders. Because of the rigor of the CFA designation, about 15 years ago, we suddenly saw huge growth in the creation of hundreds of new fancy sounding acronyms.

Acronym Growth

According to the government entity FINRA (Financial Industry Regulatory Authority), there are exactly 249 different financial professional designations ranging from a CSLA (Certified Student Loan Advisor) to a CKA (Certified Kingdom Advisor). These acronyms look important after a person's name, however the overwhelming majority of these designations can be bought and earned over a short period, many times during a weekend. You read that right: sit in a virtual classroom for a weekend and walk away with a designation.

In my opinion, and I am perpetually open to debate this opinion, exactly 2 of the 249 designations are both meaningful *and* mandatory as a financial professional who is trusted with your assets and financial plan. First, your investment portfolio should only be managed by a CFA® Charterholder (CFA®). The CFA® is simply the most rigorous and difficult designation to earn in finance. It covers investment theory, derivatives, economics, quantitative methods, financial statement analysis/accounting, portfolio management, wealth planning, and ethics. Second, your financial plan and active planning strategy should only be created and managed by an experienced Certified Financial Planner™ (CFP®). CFPs have years of training and testing in the field of financial planning. They're also required to complete 30 hours of continuing education each reporting period. To me, every investor who wants to maximize their finances from a planning and risk-adjusted return basis should have an experienced CFA® and CFP® managing their finances. Anything less should be unacceptable.

Yet why are fewer than 10% of advisors CFA® Charterholders[3], fewer than 35% of advisors CFP® practitioners[4], and over 40% of advisors have less than 10 years of experience[5] in our industry?

Just as I would only allow an MD to treat me medically, and a CPA to do my taxes, I would only allow an experienced team of CFA® Charterholders to manage my portfolio and only a very experienced CFP® to create a financial plan for my family – period. At Osborne Partners, you cannot earn an interview to be hired on the investment team without a CFA, while CFP® professionals with fewer than 10 years of industry experience simply cannot work here.

"I'm a Fiduciary!"

Sometime in the mid-2000's after the internet bubble burst, the public started to understand the difference between a salesperson broker-type and a true RIA. One was a salesperson, selling products for fees, and one was a true fiduciary. Billions in assets started to shift away from brokers and to fiduciaries like Osborne Partners. Since opening a Registered Investment Adviser firm is so simple, brokers and broker teams realized all they had to do was leave the brokerage world, register to be an RIA, start a new company, (make sure the firm name is tree, mountain, or water related), and build a website depicting happy retired couples on a boat or playing on the beach with their grandkids. Now suddenly, after paying some filing fees, "Spruce Stream Mountain Partners" is a fiduciary, literally overnight. Of course, their business of selling and investing in products is exactly the same, but now they are a "fiduciary". A frustrating part of our industry.

Fees

It seems like fees are always disclosed in our everyday lives, yet most investors have no idea that they pay two, three, or four layers of fees on their portfolio and financial plan. Since the majority of firms either do not have the required acumen to manage portfolios or have simply given up trying, the portfolio management side is nearly always outsourced to outside managers, funds, or other products. Most of the time firms either lead their marketing effort with "our financial planning is great" or "I'm your quarterback who monitors these managers and funds for you." Well, the common practice is first you have to pay your "quarterback" 0.75% to 1.25% to watch your portfolio. Next, you have to pay the actual managers to manage your money – add on another 0.50% or so. Assuming there are not additional fees for trading, financial planning, consulting, etc., your next fee is your capital gains bill – which I've seen vary from 0.10% to as high as over 1.00%. On the fee invoice you will see what the advisor solicits as their management fee. This only represents the first "quarterback" fee. Now you need to add on the outside product fees and capital gains bill. So all in, you would probably pay 1.30%-2.00% year after year at the majority of RIAs. And that doesn't even factor in the impact of capital gains taxes in taxable accounts. This has never been the case at Osborne Partners…and never will be. We avoid using outside managers or products and we invest portfolios in a tax efficient manner.

Taxes

As a former mutual fund manager, I'm familiar with the common fund manager compensation structure: bonuses are paid on gross performance. The amount of capital gains generated were irrelevant to my bonus check. When you own a portfolio of products, you have literally no control over your tax bill from year to year. You will never own a tax efficient portfolio. At Osborne Partners, it is very common to see new clients arriving with portfolios that have paid 0.75% or more in annual capital gains fees alone.

Control

Additionally, when you own funds and products, you have no idea what you own in your portfolio. Many managers own the same stocks even if their "style" is different. It is also common for us to analyze prospective client portfolios and they could own most of the largest S&P 500 holdings in six, seven, or eight different funds. The prospective client has no idea, but even more frightening is that their previous "advisor" has no idea.

Performance

Historically, I would guess if you asked all 18,500 RIAs in the country for their long-term performance record, this would be the most common answer: "Well Justin, since we customize portfolios, all of our clients have different performance, so we cannot show performance, but we have happy clients and (fill-in the blank) assets under management, so you will do great here. Have you seen our financial plans? They are very thorough. We also take select clients to play golf at (fill-in the blank) golf club". Osborne has always strived to be the antithesis of this by having client composites of actual client performance for different investment allocations, with some composites dating back to the late 1990s. We also present clients their returns for each asset class, in each time period, against each appropriate asset class benchmark. This seems so simple, yet why do most of the 18,500 RIAs fail to operate this way?

Size – "Roll 'Em Up!"

With over 18,500 RIAs in the country, Osborne Partners is usually ranked somewhere around the largest 1% on an amount of assets under management (AUM) basis alone[6]. We are certainly not small. But the number of firms that are in the market trying to buy every other smaller firm with a pulse is incredible. Size (billions in management) is becoming the only thing that matters. As a very knowledgeable and well-known private equity partner recently told me, "In the not so distant future, every wealth management firm in the nation will be owned by less than ten large roll-up firms. Just like the accounting world has "The Big 4", the wealth management industry will be the same." Well that sounds fun for the wealth management firm owners who are cashing out for their retirement in their 70's, or to simply grab a check from a larger entity. But how do employees and clients feel after their firm has been acquired by a behemoth? The pitch to clients revolves around added depth, technology, and new product opportunities. Of course, we all know when a roll-up firm has 50 different offices where 50 different firms are housed, these firms are not sharing clients, knowledge, ideas, etc... In many cases they are actually competing against each other. They are individual firms, owned by one larger corporation. On the employee side, I have yet to meet an employee of a rolled-up firm who said, "wow, I really like being a part of this large entity. They provide X, Y, and Z for me, and I love it here." What is the roll-up model? Buy a bunch of firms, have them share infrastructure, cut costs through saving on infrastructure and reduce the number of employees. Watch your margin go up, then repeat with the next acquired firm. Interesting that the word "client" rarely enters the discussion.

We have chosen to grow organically by adding the best possible specialists in investment management, financial planning, and operations. If they have clients who follow them here, that is great, but we are hiring the person and their expertise, not their assets.

Passion

It may be easy to understand why I am so passionate about educating individuals about our industry. So many people do not understand their portfolio, the fees, the taxes, and whether their firm adds any value.

I will always believe that combining the best CFA® Charterholders and CFP® professionals together with a time-tested discipline on the investment management side, and a thorough customized financial plan on the financial planning side results in happy clients and extremely high client retention. On the employee side, when you hire the best and their only job is to focus on what they do best – planning, analysis, or service, they love coming to work every day. This is why we have stellar employee retention at Osborne Partners. I saw a sad statistic recently that wealth management firms have annual employee turnover of 36% (study by Ensemble Practice). Many of these resumes find their way into our email inboxes.

Why Doesn't Everyone Manage Their RIA This Way?

Simple. Because it is hard. It is hard to build a team of the strongest, most experienced CFA® Charterholders who religiously follow our investment discipline, yet have modest personalities. It's hard to assemble a team of the best CFP® professionals, with vast amounts of experience and knowledge, who only want to optimize clients' financial lives…day in and day out. It is hard to build a management team that focuses only on making the client experience the best, and the work environment for our team optimal, (yes, that is why our main office is a high-rise penthouse with multiple outdoor decks and our kitchen cabinets have more snacks and drinks than a grocery store).

It is obvious I am immensely proud of our team and our philosophy. I know our clients feel our passion every day. Inevitably, our success is non-existent without our clients, and they are the real stars here. We will always stay true to how we built and manage this company – the hard way, but best way.

In an industry full of meaningless designations, high fees, and no discernible performance, I want as many consumers as possible to understand our opaque industry.

[1]Statista Research Department (17 July 2023). Total number of SEC-registered investment advisors 2000-2022, https://www.statista.com/statistics/1251310/total-number-of-sec-registered-investment-advisors/. Accessed 28 March 2024.

[2] RIABiz (27 February 2024). Plague of failed hires at strapped RIA firms 'come back to bite them,' making the process of closing bandwidth deficits falter, two new studies show, https://riabiz.com/a/2024/2/28/plague-of-failed-hires-at-strapped-ria-firms-come-back-to-bite-them-making-the-process-of-closing-bandwidth-deficits-falter-two-new-studies-show. Accessed 28 March 2024.

[3] WealthManagement.com (27 February 2015). Part 4: Advisor Professional Designations Held or Being Pursued, https://www.wealthmanagement.com/practice-management-operations/part-4-advisor-professional-designations-held-or-being-pursued. Accessed 20 July 2022.

[4] There are 263,030 personal financial advisors in the U.S. according to the Bureau of Labor Statistics (May 2021). There are 93,997 CFP® professionals in the U.S. according to the Certified Financial Planner Board of Standards, Inc. (Sept. 2022).

[5] 2020 Schwab RIA Benchmarking Study

[6] Investment News.com. RIA Data Center. https://data.investmentnews.com/ria/