A Word to the Wise Advisor

By Kerry Pechter *Fri, Oct 21, 2016*

At the Money Management Institute Fall Solutions conference in Boston this week, one of the presentations focused on the right and wrong words to use when explaining the impact of the DOL fiduciary rule to existing clients.

In a financial world that's shifting from commissions to fee-based compensation, how will advisory firms deal with the fact that most clients don't like the word "fees"?

As broker-dealers scramble to adapt to the Department of Labor's new fiduciary rule over the next six months, one challenge will be to teach thousands of advisors how to explain the effect of the new rule on, among other things, fees—a topic that increasingly concerns investors.

"There will be more conversations about fees," Invesco Consulting's Gary DeMoss of told hundreds of mainly sell-side executives at the Money Management Institute's 2016 Fall Solutions conference in Boston this week. "It's an awkward conversation to have, but your clients will want to hear it from you first.

"You must explain the 'what' of DOL, the 'why' of DOL, and how it will impact them. Make it about them and how it's beneficial for them," DeMoss said. He drew a ripple of laughter from the audience when he warned them not to say, "I must put now put your interests ahead of mine. Bummer."

The MMI membership consists of asset managers, broker-dealers, TAMPs (turnkey asset management programs), and technology and solutions providers. The audience at the conference was mainly sales and marketing executives and others on the product and distribution platform side of the investment business.

Laughter was not abundant at the conference. Manufacturers and distributors of mutual funds face significant disruption by the DOL rule, as the brokerage industry shifts toward the sale of institutional share-class funds, index funds and exchange-traded funds by fee-based advisors.

Simultaneously, it is shifting away from the actively managed funds that for years have produced commissions for advisors and provide revenue-sharing dollars for broker-dealers.

Broker-dealers are also expected to vastly reduce the number of fund offerings on their shelves.

In a separate presentation at the conference, A.T. Kearney predicted that the U.S. financial services industry will lose about 6.7% of its $300 billion in revenues over the next five years—much of which will come at the expense of the wealth management businesses of the four so-called wirehouses: UBS, Wells Fargo, Bank of America/Merrill Lynch and Morgan Stanley.

As one broker-dealer executive put it, "For the last several years, advisors have been moving money out of higher cost shares into institutional shares that pay less or no revenue sharing. The move to ETFs is doing the same thing. The DOL rule will only accelerate that. I think everyone agrees that eventually revenue sharing will go away—at least in its current form. The question for each firm is how will they transition to this."

Part of that transition will involve training advisors to explain the changes to clients, most of whom don't know how much they're currently paying in fees. The explanation may include the news that the client is being moved from commission-based compensation to fee-based or to an automated digital advice platform.

To help companies solve this communication problem, Invesco Consulting hired Maslansky + Partners, a firm once associated with political-linguistic guru Frank Luntz. The firm studies how people understand specific words and messages. It pioneered "Live Instant Response Dial" focus groups, where participants indicate their reactions to a speech that's in progress.

"There will be more conversations about fees and we need to be doing it the right way," DeMoss said. It's essential, he said, for the advisor to know exactly what and how each client is paying for services; otherwise, the advisor will look bad. Firms that try to avoid talking about the DOL are making a mistake, he added: "Anything unexplained or unexpected will be a problem down the road. Don't leave anything out there for clients to find out about on their own."

The word "fees" is itself problematic. During Invesco focus groups, people were asked to name the word they liked least: fees, charges, costs or commissions. "Costs" and "charges" were neutral words, with only 6% and 15% of people objecting to them, respectively. "Commissions" was liked least by 26%, but 53% of the group members liked "fees" the least.

There was some question about whether most clients know what “fee-based” compensation means. DeMoss believes that clients know that it means a percentage of assets under management and that “fee-based” never includes commissions. [“Fee-based” advisors do accept commissions, if properly licensed, according to **Yahoo finance**.

In Maslansky focus groups, people were also asked which type of account sounded most appealing to them. The overall answer was “flat-fee” accounts, with a 44% share of the vote. “Fee-based” came in second at 35%, followed by “advisory” accounts and “level-fee” accounts. There was a question whether clients believed that flat-fee believed that it meant a fixed dollar amount or a fixed percentage of assets.

Focus group participants were also asked which would bother them more—news that they would incur “unexpected fees” or that their portfolios had “underperformed.” By a roughly two-to-one margin, respondents said they would rather hear about underperformance than new fees. When asked whether they would rather have 8% returns and a non-attentive advisor or 6% returns and an attentive advisor, 69% chose the latter.

Going forward, advisors will need to be upbeat without raising client expectations too high. “Talk about the benefits of the DOL rule and then talk about what it is. Make it all about the client and how it will help them.” Advisors should make a habit of using the word “you” and not the word “I,” DeMoss said.

“Fear-based selling is out,” he told the audience. “So are pretty models, impressive mansions and superlatives about performance potential. Blaming the government doesn’t work. Clients don’t want to hear bashing.” Above all, simplify the process, no matter how difficult that may be. “It’s easy to make investing look hard,” he added. “It’s hard to make investing look easy.”