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OCTOBER–NOVEMBER 1995

PLANNER

IDEAS FROM LEADING EXPERTS IN FINANCIAL PLANNING

TRENDWATCH

Education or Advice? Today's hot topic in retirement plan fiduciary responsibility is education for retirement plan participants. Sponsors who have implemented self-directed plans can avoid fiduciary responsibility, under Department of Labor (DOL) Reg. 404(c), by providing investment education so plan participants can make informed decisions. There is no clear distinction between education, which is mandatory, and advice, which restores the plan sponsor's fiduciary responsibility supposedly shed when opting for 404(c). The DOL promised an interpretative bulletin to provide guidance in distinguishing education from advice. In the meantime, the DOL's quick test: If the information focuses on investments, it is more likely to be educational. If it focuses on the individual, it is more likely to be investment advice. *Pension Management,* September 1995, page 19.

Need to Understand Benefits of Up-Front Premiums for Life Insurance. A misunderstanding about what a client actually buys with an up-front life-insurance premium could cause problems that seem to arise from the failure of the producer to differentiate between the two methods of prepayment: the temporary insurance agree-

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PRO: Wrap-Fee Programs Work

by Mark J. Smith

Mark J. Smith, CPA,CFP, of M.J. Smith & Associates, Inc., Aurora, CO, explains why a wrap-fee program could work for your clients. His firm designs investment portfolios using both wrap-fee programs and no-load mutual funds.

One of the hottest trends in the financial services industry in the last ten years has been the increased use of wrap-fee programs. Today, there is over $100 billion in money under management in these programs, which are offered by most major wire houses and other NASD financial planning broker-dealers. If your clients have not already been exposed to this investment-management option, the chances are high they will. You should be prepared to help your clients determine

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by J. Ben Vernazza

J. Ben Vernazza, CPA, PFS, of IMS/CPA & Associates, Inc., Aptos, CA, explains why a wrap-fee program might not work for your clients. His firm manages investment portfolios using no-load mutual funds.*

Rap: A counterfeit half-penny during the time of King George I of England (1714-27).

[W]rap-Fee Account: A percentage fee charged for yearly investment management covering all charges including advisory fees, trading commissions, transaction charge and reporting.

Are wrap-fee accounts currently offered by brokers and "fee" planners a good deal? (A "fee" planner in this context is a financial planner who once was a commission-compensated planner, but now claims to be a fee-compensated planner.) How do wrap-fee accounts compare with

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*This article is based on material published in *The CPA Investment Strategy Letter* by IMS/CPA Associates.

TRENDWATCH

Continued from page 1

ment (TIA) and what is generally called a conditional receipt. A conditional receipt guarantees insurability from the point of the physical exam forward although underwriting is not completed. Today, this method is typically used only when the policy is relatively simple, the coverage amount small, and the insured is young. With the growth of the older age market and more complicated underwriting, most carriers have moved to the TIA, which protects the carrier against changes in health during the underwriting process. The TIA does, however, provide protection if death occurs during the underwriting process. *Bests' Review, Life and Health*, September 1995, page 60.

Watch Out for Intra-Family Loans and Loan Guarantees. Borrowing from a family member or having a relative guarantee a loan can be undermined by unfavorable income and gift tax consequences. If a family member defaults on a loan, the taxpayer-lender must try to qualify for a nonbusiness bad debt deduction—a short-term capital loss. In denying bad debt deductions, the IRS treats the lender as having made a gift equal to the remaining balance. The lending family member can lose the bad debt deduction and may face additional tax liability if the gift exceeds the $10,000 annual gift tax exclusion. Family loan guarantees can create similar gift-related problems, as well as difficulties in valuing the guarantee. *Journal of Accountancy,* October 1995, page 45. ◆

From the Chair Emeritus: Reminiscences of the Past Two Years

By James A. Shambo

James A. Shambo, CPA/PFS, Chair Emeritus of the American Institute of CPA's Personal Financial Planning Executive Committee offers an eclectic potpourri of thoughts for his last article in this series.

The last two years were the fastest of times and the slowest of times. The challenge has been truly one of the best professional experiences of my career. I can, therefore, highly recommend involvement in PFP Division activities for all members. This has been a profound learning experience for me and I am grateful to all who have supported me throughout my tenure.

Media and Public Relations

Personally, I am most proud of the relationship the PFP Division and I have developed with the media. I remember the trepidation that the responsibility of representing the PFP Division evoked when I was offered the Chair. But a hot, sweaty, media blitz in New York City in August 1994, forever changed me and I might add that the same change of perception applies to the overall media-CPA relationship.

I recently had a discussion with a magazine writer who admitted that CPAs are increasingly becoming the source of choice for financial planning information. We can thank Dan Mucisko, of the AICPA's Communications/Public Relations Division, for making the initial contacts. In addition, the PFP Section key contact members are to be congratulated for providing the media with responsive, clearly understandable, objective advice.

One of the most exciting efforts the PFP Division is involved in is the recently unveiled AICPA public relations campaign. If you have not seen or heard the television or radio ads, get ready to have your socks knocked off. Simply put, the ads are outstanding. I know because I have made trips to several state and local CPA societies and chapters this fall to showcase the ads. The reviews have been great.

The ads place a strong emphasis on the CPA as a financial adviser. And while not specifically mentioned, financial planning is given strong support.

As I mentioned in my last column, the PFP Division has met with Hill Holiday, the AICPA's public relations firm and you should receive a report on our progress in the near future. Our public image building campaign and outreach efforts within the profession is starting to have an affect. The enthusiasm I have witnessed in my travels is contagious. This is reflected in our relations with state society PFP committees. A relationship that has brought us closer to our broad constituency.

New Publications

I am gratified that the first annual *PFP Practice Handbook* was issued during my tenure. When I received my copy, I popped open the vacuum seal protecting the floppy disc (hiding on the inside back cover) and downloaded the WordPerfect© data files. In an operation I found to be truly slick, I have customized all the checklists and letters to fit my firm's stationery, made the changes I thought necessary to meet our practice's needs, and stored it all on my PC ready for use. A truly easy-to-use practice aid that I received as a benefit of membership in the PFP Division.

The newest addition to the PFP Library, *Guide to Registering as an Investment Adviser,* contains a wealth of editorial explanation and official documentation to assist you and your legal advisers in reach-

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Murray B. Schwartzberg, Esq.
Editor

Phyllis Bernstein, CPA
Director

ing a decision on the important question of registering as an investment adviser. Thanks to Chuck Kowal and the Legislation and Regulation Task Force for their fine effort. There will be a registration workshop at the 1996 Annual Technical Conference in New Orleans (January 8–10, 1996).

Personal Financial Specialist

I have been very happy with the growth of the Personal Financial Specialist (PFS) designation over the past two years. Our image-building campaign and outreach within the profession is having an effect, and I am excited about the future.

Making It Work

I must say thank you to all of the Executive Committee, subcommittee and task force members I have served with over the past six years. It has been an honor to be associated with this group of talented and hardworking volunteers. The staff of the PFP Division has stayed in step with our volunteers. I know they share our passion for the CPA as the premier source of financial planning services. Each and every one of these people deserve our thanks.

Conclusion

My first impressions of the AICPA's new President, Barry Melancon, has reinforced my expectations that the AICPA will become more responsive to its members. As part of this change for the better, I expect the PFP Division to seek new ways to improve the delivery of its services to our members in line with Barry's efforts. I intend to vigorously support Barry in his efforts to streamline the AICPA and to place the provision of member services higher on the priority list.

I expect Ron Cohen, the incoming AICPA Board Chairman, to support Barry in instituting these changes. In the short time that I have known Ron, I have found him to be a great listener and willing to engage in a two-way exchange of ideas.

Finally, I want to say thank you for the opportunity to lead you for a brief period of time. I trust that I have served you well. I treasure the experience, but I nevertheless breathed a sigh of relief when I passed the gavel to Kaycee Krysty at the October Executive Committee meeting. ◆

Spicing up Your PFP Practice: The 1996 PFP Technical Conference

The 1996 PFP Technical Conference (January 8-10, 1996) promises to add the zest of New Orleans to your PFP practice. Starting with a plenary session offering an explanation of the impact of demographics on the future of your practice (Richard F. Hokenson, Donaldson, Lufkin & Jenrette, New York), the subsequent concurrent sessions branch out into the areas of interest to you in building a sound financial planning practice.

The topics covered in the concurrent sessions include, Developing Investment Policy Statements (Eliot P. Williams, CFA, Williams Investment Counselors, Windsor, CT), Motivating Clients to Plan for Retirement (Roger C. Hindman, CPA, Price Waterhouse, Chicago), Analyzing the Cost of Investments (Peter F. Ricchiuti, Tulane University, A.B. Freeman School of Business, New Orleans), Quantitative Wealth Transfer Analysis (Robert S. Keebler, CPA, MST, Schumaker, Romenesko & Associates, SC, Green Bay, WI), Divorce: Tax and Financial Planning (Alan S. Zipp, CPA, JD, Zipp & Stouffer, CPAs, PC, Rockville, MD), Creative Use of Trusts in Estate Planning (Al W. King, III, JD, LL.M., The Citibank, Private Bank, New York), and College Cost Planning—Beyond the Basics (Kathryn K. Norris, CFP, Rothstein & Company Financial Advisors, Inc. Avon, CT and Philip T. Malinoski, M.ED., CFP, St. Joseph College, West Hartford, CT).

In addition to the concurrent sessions, several workshops provide an interactive environment in which you can participate. Among the topics to be investigated are Demystifying the Investment Adviser Registration Process (Leader: Nancy Lininger, The Consortium, Camarillo, CA), Computer Tools and Techniques for Your PFP Practice (Leaders: Barton Francis, CPA, PFS, CFP, MST, Shellenhamer & Company, Palmyra, PA and Karyn Seilhamer, Financial Computer Support, Inc., Oakland, MD), Hot Tips for Effective Media Exposure (Leaders: George Ryan, WVUE TV, New Orleans, LA, James Welsh, New Orleans Times-Picayune, New Orleans, and Andrew B. Blackman, CPA, PFS, CFP, Shapiro & Lobel, New York), and Creating Effective Client Seminars and Presentation Materials (Leader: Terry M. Stock, CPA, PFS, Friendswood, TX).

You will also gain insights into the new AICPA from the luncheon address of AICPA President, Barry C. Melancon, CPA. The conference closes with Building Client Relationships That Work! (Kerry L. Johnson, Ph.D., International Productivity Systems, Tustin, CA), an opportunity to zero in on the importance of your people skills to your practice.

In addition to the formal sessions, the conference has its opportunities to network in various receptions, a group dinner, and the annual fun run-walk. There is also a full table of activities for spouses or guests, including a boat ride into the moss-draped bayous and a plantation bus tour. Of course, there is your lagniappe, the exciting City of New Orleans — the conference hotel, the Sheraton New Orleans, is just steps from the French Quarter and Bourbon Street (contact the hotel directly at (504) 525-2500 for reservations; identify yourself as an attendee of the PFP Technical Conference to get the $145 group rate, after December 15, rooms are on a space available basis only).

Designed for the practitioner with intermediate and advanced knowledge of PFP, the conference provides up to 21 CPE credits. The registration fee is $595 for PFP Section members and PFS practitioners, $710 for all others. For further information call AICPA Meetings Registration at (201) 938-3232. ◆

Mardi Gras Mambo!

High above the twinkling lights of the breath taking New Orleans crescent, you can spend Tuesday evening (January 9) at a group dinner sampling the famous local cuisine while tapping your feet to the beat of a zydeco band ($45 per person + cash bar). See conference brochure for further details or call AICPA Meetings (201) 938-3232 for a reservation form.

PRO: Wrap-Fee Programs Work

Continued from page 1

whether wrap-fee programs make sense for them.

Although the main concern traditionally—as noted by the popular press—has been that of cost, other issues may be as or more important. This article will answer your questions about some of the issues wrap-fee programs raise.

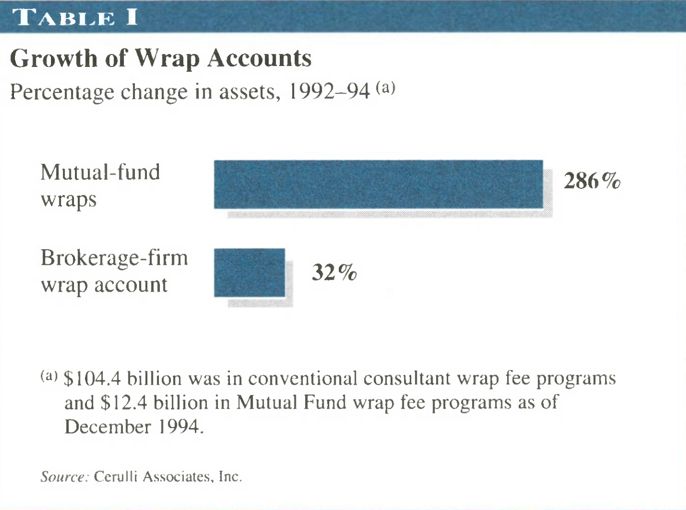

TABLE I

Growth of Wrap Accounts

Percentage change in assets, 1992–94 [a]

[a] $104.4 billion was in conventional consultant wrap fee programs and $12.4 billion in Mutual Fund wrap fee programs as of December 1994.

Source: Cerulli Associates, Inc.

The Basics of Wrap-Fee Programs

A wrap-fee program offers professional investment management for an individual's stock or bond accounts. A wrap fee is what it suggests—a single, all encompassing fee based on a percentage of the money under management. The all-inclusive fee pays for portfolio planning, professional investment management, all trading commissions, ongoing performance monitoring and reporting.

Wrap-fee programs have become popular because the adviser and manager are clearly placed on the same side as the client. Because the investment manager who makes the investment decisions is paid a percentage of the value of the portfolio, the conflict between activity and compensation is removed. The investment manager's fees will grow only if the account grows. Therefore, active trading, unless it leads to higher profits, will not be profitable to the investment manager.

See Table I above for a graphic illustration of the more than 286 percent surge in the two-year period ending in December 1994.

Wrap-fee program expenses are usually a combination of two components.

1. The first component is the compensation for both the investment manager and broker-dealer overseeing the investment manager. This fee is typically 1 percent for equity and balanced accounts and 0.5 to 0.75 percent for bond accounts.

2. The second component is a fee in lieu of commissions to compensate the broker-dealer for trading costs and the fee-based financial planner for the personal services rendered to the client. This fee is usually 1.5 to 2 percent for equity and balanced accounts and 0.5 percent for bond accounts.

Therefore, combined "wrapped" costs are generally 2.5 to 3 percent for equity and balanced accounts and 1 to 1.5 percent for bond accounts.

Investment Advice Options

The two alternatives available to clients, if they need assistance using a wrap-fee account is to:

■ *Use a wrap-fee consultant:* Here the conflict of interest is generally eliminated. However, there still exists the concern about the costs discussed above. [*Editor's note:* A wrap-fee consultant is a "fee" planner, who hires an investment manager rather than personally managing the client's money.]

■ *Use a mutual fund wrap program:* Mutual fund wrap programs are increasingly popular. They provide an investment manager who actively selects, monitors and manages a no-load mutual fund portfolio. Many mutual fund wrap programs are offered through NASD member firms including Charles Schwab and Fidelity, to name but two.

The typical charge for this service is an ongoing fee of 1 to 1.5 percent of the portfolio's value. While clients only see the 1 to 1.5 percent fee that the investment manager charges, they often do not see the mutual funds' expenses, which may range from 0.5 to 2 percent in addition to the funds' trading costs, which are included in the fund's purchase price of the securities. So when expenses and commissions are factored in, investors in a mutual fund wrap program can end up paying as much as or, in some cases, more than a typical wrap-fee program.

Table II below compares the cost for a client between using a wrap-fee account and a managed mutual fund program. It reveals that the cost of a wrap-fee program may be lower than a managed mutual fund wrap program. The cost of either,

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TABLE II

How Costs Add Up

	Advisory Fee	Transaction Cost	Mutual Fund Expenses	Mutual Fund Transaction Costs	Total
Wrap Account					
Equity & Balanced	1%	1.5 to 2% [a]	N/A	N/A	2.5% to 3%
Fixed Income	.5% to .75%	.5% to .75% [a]	N/A	N/A	1% to 1.5%
Managed Mutual Funds	1% to 1.5%	N/A [b]	.5% to 2%	.5% to 2% [c]	2% to 5.5% [c]

[a] Or actual commissions if "unwrapped."

[b] Some programs may have negligible ticket charges to buy or sell the mutual funds.

[c] Per Gerald Perrits' book *The Mutual Fund Encyclopedia,* mutual funds can easily be expected to incur what is equal to .5% to 2% in trading costs per year. These expenses are above and beyond the expense ratios published. These costs are added into the cost basis of the stock and therefore increase costs and are not reflected as expenses normally.

CON: [W]rap-Fee Account Thingamabob

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the costs of true fee-only financial planners? The answers to these questions are important for the CPA financial planner.

Who Markets the Wrap-Fee Account?

Wrap-fee accounts are currently being offered to investors by brokerage firms and financial planners to clients who are concerned about commission costs. In a wrap-fee account, the broker or financial planner quits trying to manage the client's money and hires a money manager. This marriage in marketing by broker-dealers, financial planners, and investment managers offer a "no commission" option to clients willing to pay up to 3 percent a year in fixed wrap fees.

In fact, since in the mid-1980s, investment management firms have sought clients with large portfolios in an effort to expand their market. Collectively, brokerage houses are reported to be opening 6,000 to 7,000 new wrap accounts each week.

Can so may consumers be wrong? Yes. Are these people actually saving any money? No. The wrap account is another case of form over substance.

What Services Are Provided for the Wrap-fee and Who Gets the Fees?

Wrap-fee programs sold by brokers and financial planners (who the Securities and Exchange Commission categorizes as sponsors, see accompanying article on proposed SEC rulemaking) cover the costs of administering an investment portfolio, including trading commissions, transaction charges, advisory fees, reporting, and the cost of an investment manager. A typical program also may include a computerized investment plan, asset allocation guidelines, and a search for a compatible investment manager. The sponsor or other delegated party, for example the

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TABLE I

Core Service Comparison

	Fee-for-Service Adviser	Wrap-Fee Account
Fees (based on assets under management)	Based upon time, effort and complexity. Adviser fees typically 1.8%–0.5%, with transaction fees adding 0.4%–.02%.	First $500,000 3.0% Next $500,000 2.2–2.5% Next $500,000 1.5–2.0% Next $500,000 Negotiable
Risk Definition	An objective analysis is done to determine and quantify the amount of risk necessary to achieve or maintain a client's financial independence and other financial objectives.	Generally the selling broker/"fee" planner determines the risk tolerance using subjective investment classifications such as aggressive growth, growth, income, etc.
Investing Philosophy	Portfolios individually designed for each client. Client retains full control of funds at all times and approves all investment transactions.	Client money is effectively pooled and invested at the discretion of the money manager. Client control is limited to changing money managers.
Personalization	Client deals directly with the person responsible for all investment decisions, strategies, allocations and monitoring.	Broker or"fee" planner normally serves as client contact. Generally, client control is limited to changing money mangers.
Other Services	Financial assistance is provided in insurance purchases, estate planning and other personal finance areas.	Other services generally unavailable or subject to additional fees or commission charges.

TABLE II

Fee Comparison

	Average Account Size		
	$100–200 Thousand	$400–600 Thousand	$1–1.5 Million
Avg. Assets Under Management	$146,102	$553,721	$1,305,211
Wrap-Fee Program Two-year Cost			
1st $500,000 @ 3% each yr.	$8,766	$30,000	$30,000
2nd $500,000 @ 2.35% each yr.	0	2.525	23,500
3rd $500,000 @ 1.75% each yr.	0	0	10,682
Total Wrap Fee for Two Years	$8,766	$36,525	$64,182
Actual Fee-For-Service Fees & Actual Transaction Costs for Two Years (1989–90)			
Fees Charged	$3,722	$ 8,462	$15,815
Actual Commissions & Transaction Costs	424	3,318	6,776
Total Fees/Costs for Two Years	$4,146	$11,780	$22,591
Difference (Fee-For-Service Savings)	$4,620	$20,745	$41,591
Percent Savings with Fee-For-Service	53%	57%	65%
Annualized Cost as a Percentage Avg. Assets			
Wrap-Fee Account	3.00%	2.94%	2.46%
Comparable Fee-For-Service and Costs	1.42%	1.06%	.86%
Fee-For-Service Savings	1.58%	1.88%	1.60%

PRO: Wrap-Fee Programs Work

Continued from page 4

nonetheless, is higher than if a client wanted to manage his or her investments personally or if the client wanted to engage a fee-only investment manager who obtains discounted transaction costs.

Practice Pointers

Our firm uses wrap-fee programs and client-directed investments in managed no-loads. In our experience, we have uncovered the following points:

- A wrap-fee program is appropriate if the client wants to or likes owning the specific securities. We find using private portfolio investment managers for managing both taxable and tax-free bond portfolios is particularly attractive because we can "unwrap" the fees and reduce the total management costs to a range of 0.5% to .75%. If the client personally owns the bonds, additional peace of mind can be gained in a bad bond market, such as 1994, because paper losses can disappear as the bonds mature.
- Wrap-fee programs are not typically appropriate for small portfolios (generally under $500,000). It is important to diversify among investment management styles. Because most wrap-fee programs require a $100,000 minimum, it is hard to obtain the desired investment management diversity with small portfolios. Instead, use a managed no-load mutual fund approach with small portfolios.
- Wrap-fee programs do not work with detail oriented clients. With a wrap-fee program, clients see every transaction, both good and bad. In contrast, with direct investment in mutual funds, the client does not see the funds' daily activity. With both privately managed accounts and mutual funds, stocks and bonds frequently are sold at losses. If your client has a difficult time living with the knowledge of these transactions, use mutual funds. The funds' trading is not observed.
- Wrap-fee programs are helpful if you want tax planning flexibility. Because tax consequences are generally uncontrollable in mutual funds, wrap-fee programs have an advantage. As a result of the client's direct ownership of the individual stocks and bonds making up the portfolio, you can work with the wrap-fee investment manager at year end to achieve the optimum tax-favored investment return.

Conclusion

Wrap-fee programs are a viable investment option for clients who seek professional investment management. The traditional bashing of wrap-fee programs as being too expensive has little merit when compared with other fee-based alternatives. Wrap-fee programs should be considered for the more sophisticated client who has a large portfolio. This is because overall costs may be less as a result of the low costs you can obtain on the fixed income side. You should consider mutual fund wrap programs for small portfolios or when the client may be disturbed by seeing the specific secuitry transactions. ◆

CON: [W]rap-fee Account Thingamabob

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investment adviser, reports to the client periodically, for example through monthly account statements and quarterly reports.

The wrap-fee is typically split three ways. The referring broker or financial planner planner gets one-third, the brokerage house (or wrap-account provider) gets one-third— to cover transaction costs, and the investment manager one-third. In some cases, as much as 40 percent goes to the referring broker or financial planner, in lieu of commissions. In many cases, once the account is opened, the broker or financial planner performs little or no additional services for the client.

Practice Pointer

To assist you in determining the type of service right for your clients, review Table I on page 5 to see a comparison of the core services provided by a fee-only investment adviser and those of a typical wrap-fee account.

Actual Cost Comparison

To further compare, in 1991 I selected a group of IMS clients at various asset levels and determined the actual fees paid and transaction charges paid for 1989 and 1990. Table II on page 5 compares the actual fee-only investment adviser charges with what the charges would have been for a typical wrap-fee account.

Why the Cost Difference?

A reasonable conclusion could be that either the wrap-fee providers are reaping overly large profits, or fee-only investment advisers are losing money. But remember, everything is relative! The best explanation for most of the variance is that there is still a commission being paid to the referring broker or financial planner by the investment manager. This can amount to 30 or 40 percent of the total wrap-fee. Additionally, there are a substantial amount of marketing expenses to be paid. We also know that discounted brokerage fees could account for part of the difference. Also, fee-for-services advisers frequently recommend mutual funds that charge management fees, but overall this should account for no more than 0.2 percent of the difference.

Thus, the cost of the wrap fee is more, because there are more hands in the pie trying to make a profit. In this case, the referring broker or financial planner is still being compensated—through a percentage of the fee-charged — for turning the client's dollars over to an investment manager. No matter what the referring brokers or financial planners choose to call themselves, paying 1 to 1/2 percent or more for referral to an investment manager and for record keeping is an inefficient way for clients to use their investment dollars. Additionally, the wrap fee is paid every year.

Continued on page 8

Wrap Fee vs. Investment Company: SEC Proposes Safe Harbor for Plan Sponsors

With the recent growth of investment advisory programs (including wrap-fee programs) the Securities and Exchange Commission (SEC) has proposed a new rule providing a safe harbor identifying whether the particular program is subject to registration requirements under the Investment Companies Act of 1940. The nonexclusive safe harbor rules exclude investment advisory programs, including wrap-fee programs, from the investment company rules provided the program is organized and operates in compliance with specified conditions.

The thrust of the safe-harbor conditions is to distinguish the individualized program—including a true wrap-fee program—from a cookie cutter variety—an investment company. That is, the investment advisory program should provide professional portfolio management services on a discretionary basis to a large number of individual clients. The size of the account is not material in the safe-harbor rule. The conditions the SEC proposes for the safe harbor are the following:

- Each client's account is managed on the basis of that client's financial situation, investment objectives and instructions. Thus, the program must be designed to meet the client's individual needs. This is a key difference between an investment advisory program and an investment company. The latter does not need to meet the individual needs of the investing client.
- The sponsor or designee must obtain information on the client's financial situation and investment objectives. In addition the clients should be asked about any specific instructions related to the management of the account. In addition, there are proposed rules on annual and quarterly reviews of the client's financial situation, investment objectives or instructions. Further, the sponsor and portfolio manager have to be reasonably available to consult with the client.
- The client has to have the ability to impose reasonable restrictions on management of the account. These restrictions indicate the types of securities to purchase or to avoid purchasing for the account. A restriction clearly contrary to in investment managers stated investment philosophy or strategy would be deemed to be unreasonable.
- The client must receive a quarterly statement of all the activity in the account.
- The client has the indicia of ownership of the securities and funds in the account. That is, the client owns the securities in the program individually. Thus, the client has the right to pledge the securities, vote the securities, receive the normal conformation and other related documents, and to proceed against the issuer as an owner (this last condition is an important difference between an investor in a wrap-fee program and an investment company).
- The sponsor must establish written procedures that would ensure that these rules and conditions are implemented.
- If a sponsor delegates authority under these rules, there has to be a writing obligating the delegate to perform as required under these rules.
- The sponsor has to maintain and retain the policies and procedures required and provide copies to the SEC when requested.

Sponsor

The proposed rules define the sponsor of an investment advisory program as a person who receives compensation for sponsoring, organizing or administering an investment advisory program, or for selecting, or providing advice to clients about the selection of persons responsible for managing the clients account in the program.

Practice Pointer

Because becoming a sponsor of an investment program carries with it some obligations, you should be particularly careful of the second half of the above definition of an investment program sponsor. Providing advice for a fee to clients about the selection of an investment manager in a investment program could make you a sponsor and perhaps an investment adviser. Although the SEC proposed rule is silent on the specific case of accountants, it does indicate that a broker-dealer otherwise exempt from registration as an investment adviser would have to register as such, if the broker-dealer is a sponsor of an investment program—an investment advisory program is not incidental to the broker-dealer business. Extending this line of thought to accountants, the incidental to the practice of accountancy exception of the Investment Advisers Act of 1940 could possibly be lost because being a sponsor of an investment advisory program is not incidental to the practice of accountancy. This determination could be made without consideration of the holding out as an financial planner rule of SEC Investment Advisers Release 1092. You should exercise caution in this area to avoid—

- Becoming a plan sponsor and inadvertently assuming the related responsibilities, and
- Having to register, unless you otherwise wish to register, as an investment adviser.

The SEC indicates that its definition of "sponsor" is broad and that more than one person could qualify as a sponsor of the same investment advisory program.

The solicited comments on the proposed rule are currently under review at the SEC. If ever finalized—this is the second attempt at rule making in this area for the SEC—the *Planner* will provide you with a prompt analysis of the practice implications. ◆

Your Investment Planning Forum

Mark June 20–21, 1996, on your calendar for the third annual Investment Planning Conference, "Wealth Management Strategies for You and Your Clients," to be held at the Stouffer Renaissance Orlando Resort, Orlando, FL. The speakers lead sessions on developing investment policies and strategies, developments affecting investment decisions, and specific types of investments. You will be able to meet other CPAs working in investment planning and visit the many exhibits. Registration is $545 for PFP Section members and PFS practitioners, $595 for others. Early-bird and group discounts will be available. Watch your mail in January for the conference brochure and registration form.

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Should Investment Decisions Be Based Solely on Cost Differences?

Basing investment decisions on the cost of the investment is not wise. Foremost, the investor needs to consider the process the adviser goes through to deliver investment advice. For instance, does the investment manager provide a personalized analysis or a heavily computer generated summary applicable to a class of investors? The emphasis should be on the *individual* client rather than a client class. How much risk does he or she really need to take? In wrap-fee account planning, the emphasis is primarily on selecting the appropriate investment manager. The investment manager search should focus on those investment managers who have the highest risk-adjusted return consistent with the client's investment objectives.

Many times risk-adjusted return has nothing to do with how much risk the client needs to take. For instance, money managers are judged on how well they perform compared to some index, such as the Standard & Poor 500. If someone does not need to have such a risky portfolio, then the portfolio should be more conservatively invested. Each client's needs and risk tolerances are different and the portfolio should be tailored to reflect those needs. This should be what the client is paying for.

Practice Pointers

You should help your clients select their investment managers using the following criteria in order of importance:

- Will there be personalized, ongoing services?
- Will the investment manager adequately analyze *your client's individual* situation and quantify how much risk is necessary?
- Has the investment manager adequately assessed the downside risk and how it would affect the portfolio, that is, what could go wrong?
- Has the *total* cost of the services as a percentage of assets under management been determined?
- Has the relationship between risk, benefits and costs of the proposed investment plan been analyzed?
- Has the investment manager voluntarily provided the federal and state required Form ADV disclosure information?

Conclusion

According to Roget's II New Thesaurus, a thingamabob is a synonym in the same class with concern, contraption, contrivance, doodad, doohickey, gimmick, gizmo, jigger, thing, thingamabob, thingamajig, and widget. Thus, investors considering wrap accounts ought to be concerned by marketing gimmicks used to wrap the various parts of this *widget*! ◆

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