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FEATURE

INVESTMENT PLANNING



Serving the Great Wealth Transfer

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The CPA Wealth Provider April 2007 cover story, "The Great Wealth Transfer," gave reasons why CPAs should consider the coming intergenerational wealth transfer as a tremendous growth opportunity and why CPA services will be in greater demand. The article highlighted several ways to provide services related to the wealth transfer: Accounting and tax reporting, estate and financial planning, investment advisory services, and administration services for trust accounts.

This article will focus on two of these opportunities: estate and financial planning, and investment advisory services. We'll explore how a CPA may segment their client base to identify specific value-added services and how to successfully provide investment management services to clients.

SIZE UP THE MARKET

The Social Welfare Research Institute at Boston College estimates that upwards of \$41 trillion will be changing hands as part of the intergenerational wealth transfer between now and 2052. Among estates valued at \$1 million or more, the average total transfer to heirs will be approximately \$1.9 million, while heirs of estates valued at less than \$1 million will receive on average \$150,000. While these sums are significant, CPAs should become strategic in delivering services to these high-net-worth clients now. CPAs have a role in the wealth management process in establishing portfolio returns to meet their clients' needs while managing risk, minimizing taxes, and generating sufficient income for the benefactor's lifetime. Deepening relationships with wealthy clients and their families so they remain satisfied and loyal clients for years to come is one of the best ways to capitalize on the wealth transfer.

CPAs interested in providing wealth management services should examine the wealth profile of their clients to

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assess the services they can provide to each client. In general, there are three segments to wealth management: ultra high-net-worth (\$50 million plus in investable assets), high-net-worth (\$1 to \$50 million) and mid-net-worth (less than \$1 million). In our experience as investment managers for more than 20 years and working with CPAs for more than a decade, the ultra high-net-worth segment is highly complex and requires a very unique set of services. The mid-net-worth segment generally is less profitable, because these clients usually are less willing to compensate properly for the CPAs' time. While you may want to help those clients, they are best served only if you have substantial scale and can implement with high automation. In our experience, clients in the high-net-worth segment of \$1 to \$50 million in investable assets represent the greatest potential business growth opportunity for CPAs, because the high-net-worth client needs can be met with professional services and yet profitably served by the CPA. Focusing on estate segmentation over \$1 million is important, because it substantiates the CPA remaining involved through the intergenerational wealth phase.

IDENTIFY SERVICE OFFERINGS

Determining what services to offer among estate and financial planning or investment advisory services requires balancing the CPAs' time involved and the value to clients. Our experience indicates that the choice comes down to the CPA developing expertise in the investment management field or creating an alliance or partnership with a full-service investment counseling and money management firm. While creating a financial plan is important,

we have found that it is only complementary to the need for portfolio management services for the majority of individuals in the \$1 to \$20 million segment.

Additionally, the CPA needs to make the strategic choice whether to bundle or separate these services. Looking at the competitive landscape, the ability to earn full-service fees on a stand-alone basis for financial planning is increasingly difficult, as many financial planning professionals bundle financial planning and investment management.

We recommend a CPA focus on the most value-added services and partner with a money manager to enlist their capabilities. If the CPA, in partnership with a money manager, provides investment advisory and financial planning, the CPA can address clients' wealth management needs directly by working on what most clients need immediately and ongoing. Therefore, by focusing first on investments, the CPA can begin to serve the highest need first for the majority of clients. In *Rochdale Investment Management's 2005 Financial Planning Practice Survey* of more than 100 CPAs, when asked about professional money management, less than 30 percent thought their clients were being properly served regarding investment policy development, appropriate investments, and ongoing portfolio manager communication. Moreover, 41 percent of CPAs felt that they could provide their clients with higher quality investment management at a lower cost than those currently managing their clients' investments. So the opportunity clearly exists for the CPA to provide certain essential aspects associated with their clients' overall investment management needs without having to be fiduciarily responsible for the portfolio

management.

The legal and demographic environment also supports the benefits of focusing on investment advisory. According to the Dow Jones Wealth Management Advisory Council, taxation has always been a top concern of high-net-worth clients, but tax concerns may leap to the forefront if the planned 2010 sunset to tax provisions occurs and capital gains tax doubles. The first priority for CPAs will be to find tax-efficient investments that ensure clients hold onto their returns. Additionally, with life expectancy increases pushing retirement to 30 years or more, clients will be hard-pressed to live on relative returns. CPAs will need to ensure their clients' portfolios are structured to generate appropriate real returns.

SELECT A BUSINESS MODEL

To pursue the growth opportunity, there are three basic business model choices, with different levels of involvement and revenue opportunity:

- Build internally all the investment capabilities. Research securities and manage the portfolio yourself or hire a financial planner, chartered financial analyst, or other professional. CPA licensing depends on involvement. Your firm does all of the work and keeps 100 percent of the fees.
- Partner or align with a money management firm to determine the strategy design, implementation, and monitoring of each client's portfolio. You become licensed and receive a higher annual fee for your personal involvement and time.
- Introduce your clients to a trusted, highly qualified money management firm and have limited involvement in the ongoing portfolio management. Fee

income is dependent on licensing requirements, which can vary by state.

Many CPAs choose the “refer out” model, because they see offering investment management themselves as a conflict of interest. In fact, only 3.1 percent of clients consider receiving investment services from CPAs a conflict of interest, according to a 2002 study by CEG Worldwide. Gregory S. Horning, CPA/PFS, co-founder and partner of Stout, Causey & Horning, P.A., in Sparks, MD, and who has been providing wealth management services to clients for several years, notes, “We have great relationships with our clients. They are very appreciative of our service in this area. They like the planning that goes into it. Our clients know we are acting in their best interests.”

Rochdale’s poll of affluent investors finds them similarly interested in understanding the type of investment management services their CPAs can offer. Among the high-net-worth individuals polled, each currently has their tax work done by a CPA, but none has investment advisory handled by the CPA. Each would be open to it, and 80 percent of those interviewed would prefer it. The ability to proactively coordinate was cited as a big plus, with one respondent noting “It would be great if my investments and tax work was in one place, so they could be looked at simultaneously each quarter.”

Still other CPAs refer out because of concerns that the client will hold the CPA accountable if the investment does not perform as expected. This is not the opinion of high-net-worth clients, in our experience. Of the affluent clients we polled recently, each agreed they would not find fault with a CPA, nor would they end their business relationship with a CPA, if there was a disappointment in their portfolio,

and the CPA, working in concert with a professional money manager, had implemented the agreed-upon investment plan.

Nevertheless, the “refer out” model may seem the easiest path, since there is no cost/investment required, no liability, and no involvement. But, that path may not serve you or your clients best. As the investment manager will have limited information and understanding of client needs, it will be challenging for the manager to serve the client completely and proactively. Importantly, there is every ability to control the quality of what the investment manager does when the CPA remains integrally involved. Finally, there is the business growth opportunity and enhanced revenue that is correlated with the CPA’s involvement.

In contrast, the “build” model provides the CPA with control of the relationship, service, pricing, and quality. But, there are several obstacles to success, most notably cost. The model requires the need to invest up front, sometimes significant sums, in people, systems, and structure, without knowing whether there will be a return on that investment. There is a limited availability of talent: skilled CFPs, CFAs, and MBAs in finance. If you hire those individuals from the outside, there may be an issue of cultural fit of the sales-oriented planner with the more consultative CPA orientation. Anyone in the firm involved in this offering will need to invest time to obtain and maintain continued expertise, which is demanding given the complexity and dynamic changes occurring in portfolio management.

The regulatory and compliance landscape also is complex, introducing liability. Given all the requirements for success, it can be challenging to achieve appropri-

ate profitability. The “build” strategy is appropriate only for very large CPA firms, given the significant upfront and ongoing investment required.

Astute CPAs choose the business model that plays to their own strengths. According to Horning, “My job is to know clients, meet with clients, and plan with clients. As a result, we don’t spend time on researching investments. We believe separate account managers have the skills to make them better at this aspect than we are.”

Our experience, based on our successful partnering with CPAs for more than 20 years, indicates that the “partner” model is superior for most CPA firm situations. It provides unlimited access to the best investment talent, a wide and diversified set of portfolio management services, and the ability to choose from several money managers and tailor the various services provided to each client. The CPA manages the client relationship and brings in experts as needed, strengthening the CPA’s role of key wealth management provider and facilitating the generational transition. There is no capital investment required, which is attractive. In this model, the costs are largely variable, which is a plus since the progress of investment management services can be grown at the pace preferable to each CPA. The model is highly scalable, with virtually no cost increases, yet with increasing revenue, and the steady annuity-like fee stream created will enhance the future business value of the CPA firm.

The “partner” model functions well across various firm sizes, from sole proprietor on up to multiple partner and multiple office firms, and for various levels of client size and complexity. Indeed, the right investment management firm

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partner can help you better serve your clients, provide consistent, long-term investment performance through disciplined adherence to asset allocation, keep you current on fiduciary standards and industry best practices, provide marketing and sales support to help you grow your practice, and enable you to out-source substantial aspects of service and administration, as desired.

The single-service CPA firm faces many challenges, as clients come to expect more services from their CPA. The future of wealth management, therefore, lies in a team approach involving disciplines such as accounting, investment management, law, and trust advisory. Each team member must bring a specialty to support the CPA.

Investment opportunities increasingly require greater expertise, given product proliferation and complexity, which will only increase in the future. A forward-looking firm will then align with experts who keep the CPA and their clients at the forefront of intelligence and innovation.

For most firms, wealth management services never will replace core accounting services. But, the contributions to firm growth and revenue can be meaningful. Horning notes, "Assets under management have been growing at a 45 percent rate the last few years. We believe long term it can be sustained at a 25-35 percent growth rate. Currently, it is 5 percent of our total revenues. We think it can become 10-12 percent." He encourages

other CPAs to take the plunge: "It is a key service line and a great annuity." CPA/WP

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