

Financial Advisory Services Alert



The PPC Advisor

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Investment Services

An Additional Revenue Stream: The Second Opinion Business

Introduction

CPA/Registered Investment Advisers (CPA/RIAs) who are currently providing fee-based investment advisory services, and practitioners who are contemplating offering such services, will find that the second opinion business complements their existing practice and provides an additional source of revenues. Any registered investment adviser can develop a reliable revenue stream by establishing expertise in providing second opinion services to investors. This article explores the opportunities for CPA/RIAs in the second opinion business.

This is not to discourage you from offering full-service financial planning and investment advisory services. The long-term financial rewards of doing so will be much higher than offering only second opinion services. However, consider the second opinion business if the full service route is too much to bite off at this time.

Why enter the money management business?

Individuals with discretionary income are entering the securities markets in record numbers. The primary reasons for this trend include: (a) baby boomers have entered their money-making years, (b) socking away savings is easier in a booming economy with a two-income household, (c) there is a concern that social security may not be all that secure, and (d) the stock and bond markets have been on an unparalleled uptrend.

Though some individuals naively venture into the online trading world on their own, many are demanding the services of investment advisers, money managers, and stockbrokers. At the other end of the spectrum, the financial services field is attracting hoards of individuals with the draw of a lucrative career. Financial services careers have traditionally been among the highest paying careers. Roughly half of the top ten paying careers are in a financial-related field.

Why should a CPA enter the financial advisory services business?

It's a natural fit. As CPAs, you are already your clients' most trusted adviser and are very closely tied to their finances. You review their brokerage statements, calculate their capital gains and losses, analyze and report their income, and offer tax advice as it relates to investments. You are already halfway there.

Executive Summary

- Second opinion services allow advisers to develop an additional revenue stream without incurring the responsibilities associated with portfolio management.
- There is a growing demand for investment performance measurement services. CPAs are ideally suited to provide these services.
- Cost analysis and risk assessment are other areas in which second opinion services provide real value to investors.

Offering financial advisory services is also an excellent way to attract new clients. People want to be able to look to one financial professional to meet their needs. By offering financial advisory services with tax, financial planning, and/or accounting services, your firm is more attractive to clients and prospects.

One of the biggest mistakes CPAs make is to partially enter the financial advisory services field. An example is where a CPA refers clients to stockbrokers, and receives minor favors in return, but does not receive fees. (Of course, if the CPA provides attest services to the client, acceptance of such fees may be prohibited. PPC's *How to Deal with CPA Financial Advisory Issues* walks the CPA through the rules on the receipt of commissions and referral fees.) Another example is where a CPA makes comments or gives financial advice to a client but does not charge for this professional advice. This is a serious mistake. Both of these examples can create regulatory problems and the potential loss of clients. Entering the financial advisory services field can be both gratifying and economically rewarding, but do not do it halfway.

The second opinion business

Perhaps the simplest and least complicated service of the financial advisory services business is the "second opinion" business. In second opinion engagements, the CPA/Registered Investment Adviser (RIA) is not the primary manager of the client's investment portfolio. Rather, you are working with your client and his current financial advisers and brokers. This service is ideal for those who may be reluctant to manage portfolios themselves, but want to offer clients a valuable investment-related service. Since second opinion services are performed periodically (e.g., quarterly or annually) they require much less of a time commitment than managing your client's portfolio on a continuous basis.

What second opinion services can you offer?

Assume that one of your current clients or a potential new client already has an established working relationship with a stockbroker or money manager and does not want to move his business. The following are some of the services you can offer under the umbrella of the second opinion business.

- Performance Analysis

When a stockbroker is managing your client's investments, it is rare that the broker or brokerage firm tells your client what his actual account performance has been quarterly or yearly. Only recently have brokerage firms started displaying on monthly statements the change in value of the account from one month to the next. If an investor does not know how his individual investments and his portfolio as a whole are performing, he has a very difficult time making investment decisions. You can provide valuable information by calculating performance measures that enable your clients to intelligently manage their investments.

Note: A powerful portfolio management software package will be a tremendous asset in providing these services. PPC's *How to Transition Your Practice to Financial Advisory Services* provides detailed information on portfolio management software.

Many advisers mistakenly believe that if a client is mainly in mutual funds, that the adviser can offer little in the way of performance analysis. Not so. For example, if a client owns mutual funds, figure out what the client paid in fees and commissions at the outset and what the annual fees and commissions are



for the fund. Some money managers charge a client twice on one mutual fund—a commission to sell the client the loaded mutual fund as well as a fee for managing the money. Identifying inappropriate expenses is a valuable second opinion service.

Another misconception is that if an investor is managing his money himself, he has little need for a person offering a second opinion business. In fact, the opposite is true. The burgeoning online brokerage industry is evidence that more and more people are taking control of their investments. They are drawn by the tremendous cost savings in the low commissions paid by trading on the Internet. Also, many people have found that the advice they have been receiving from stockbrokers over the years was ill-advised or colored due to conflicts of interest. These people, more than ever, need an individual who can offer them second opinion services. The investor can still make his own decisions, maintain control, and keep his commission costs down. Yet with your evaluation of his investment portfolio, the client can rest assured that what he is doing on his own is reasonable and compares favorably with the rest of the investment world.

- Comparative Analysis

Comparative analysis is a service wherein you first calculate what your client's investment performance has been (as in the "Performance Analysis" discussion) and then compare this performance to various indices. The index may be the Standard and Poors 500 (S&P 500), the Dow Jones Average, or the Lehman Bond Index, to name a few. The proper index is determined by first assessing the investment objectives of your client. The goal of the "comparative analysis" is to inform your client how his account is performing in comparison to how his portfolio *could* or *should* be performing. The results of the comparison are usually a basis for advice. The advice may be in the form of suggestions to adjust the portfolio structure or maybe to change money managers.

- Cost Analysis

Cost analysis is similar to the two prior analyses except that it concentrates solely on the issue of costs that a client is incurring to have his money managed or his portfolio traded. The costs typically consist of commissions, spreads, and fees. Many times clients are unaware of these costs or have not taken the time to calculate what the total fees are and how they may be affecting the performance of the account. Once you have calculated these costs, you can then do a comparative analysis with industry standards. For example, the client's actual costs associated with a particular large cap mutual fund can be compared to the average costs of all funds in the large cap category.

- Risk Assessment

This is an area where CPAs can excel, because unlike virtually all stockbrokers, CPAs do not have a built-in conflict of interest. Stockbrokers and some money managers earn their living regardless of whether or not the client makes money. And many firms have an underlying interest in pushing certain investments because they are the market maker or underwriter for certain funds, stocks, and bonds. Consequently, stockbrokers have a tendency to



downplay the risks of investments. This is where a CPA can shine. You can offer to evaluate your client's trading and portfolios and tell the investor the investment risks the broker may have omitted.

- Financial Watchdog

This is an area where CPAs may fall short, even when performing accounting services. Sure, CPAs who are only performing accounting services are not paid to comment on a client's investments or trading records. However, as a matter of providing good client service, the CPA may have a moral obligation to apprise a client if he feels that some of the trading he is reviewing might be unsuitable. (Of course, if you are the client's financial adviser, then this service is redundant.) But you should offer this service in combination with your second opinion business or even your usual accounting business. For a fee, you can review the trading activities in your client's accounts and comment on any activity that you feel is:

- Unsuitable.
- Extremely risky.
- Very costly.
- A conflict of interest.
- Illegal or otherwise inappropriate.

This watchdog service is most needed where you have a client that has a stockbroker or money manager who either directs or controls most of the investments. It is also most appropriate where your client is unsophisticated concerning securities or is too busy to monitor his portfolio.

Many CPAs have been called into a securities arbitration between an investor and a broker. The CPA, when performing a second opinion engagement, is sometimes put on the spot as to what he told or failed to tell his client about the trading in his client's account. Assumptions are made that if the CPA calculated the investor's year-end capital gains and losses, then the CPA should have been aware of the excessive trading. Even if you do not offer this watchdog service as a separate billable service, as a matter of good client service, you should at least discuss with your client abnormalities that you detect. If you do not want to perform this second opinion service, then make it clear to the client and document that your policy is not to review or comment in any way on the client's investments or trading. Then there is no confusion if a lawsuit ensues between the investor and his broker.

What can you charge for the second opinion business?

The second opinion business is strictly fee based. Commissions are not involved because buying or selling securities is not part of this service. It is common to charge an hourly rate for this service. The hourly rate will probably be commensurate with the hourly rate for your CPA services.

You can also charge a flat fee for the second opinion services. Many clients prefer flat fees, because they know ahead of time exactly what it will cost. As in your



traditional CPA business, there are downsides of flat fees. A common problem is when the client asks for more services and advice than you anticipated when setting the flat fee. A second problem is that the flat fee might be so low that necessary services cannot be adequately performed and the final product suffers. In offering your second opinion business, it is a smart practice to have a pre-set package to offer to clients. The package should offer all of the services you will provide under your second opinion business. You can give a range of what the total package would cost under an hourly rate or you can offer a fixed fee. You should also attempt to partition your services so you can increase or reduce the costs to your client by adding or deleting certain services.

How can you market this service?

Start by marketing to your existing clients because the confidence and trust required to build an advisory practice has already been established. Appendix A is a sample marketing letter to your clients. A copy of the letter can be downloaded from PPC's website at www.ppcinfo.com/fas/clientletters. You can then edit and distribute it to clients, potential clients, and referral sources as you see fit. (However, the material may not be posted in a website area available to the public or shared with another firm or association of firms of which you are a member.) Remember one advantage of starting with your existing customer base is that you start the referrals coming in sooner.

Once you have marketed to your existing clients, it is time to approach new clients. Your financial and investment services should generally be offered as part of a total range of services. Like existing clients, new clients will be interested in the one-stop shopping concept. Mailings, seminars, and speaking engagements can also open doors to new clients. (See PPC's *How to Market Financial Advisory Services* for extensive guidance on using these marketing tactics.)

Conclusion

The second opinion business is a natural for CPAs because it leverages their existing knowledge of the client's finances and requires skills that most CPAs possess. They may also be comfortable providing these services if they have little investment experience. For some CPAs, there is less pressure and responsibility with performing a second opinion service as opposed to an individual who is managing a person's money for investment performance. This is not to say that offering a second opinion business should be taken lightly. It is just generally less of a time commitment, but it is an enormously valuable service.

Note: This Financial Advisory Services Alert was written by Douglas J. Schulz, President of Invest Securities Consulting, P.C. (Invest). Invest manages money and offers financial consulting on a fee-only basis. He has conducted financial investigation and due diligence for numerous brokerage firms, investment banking firms, and merchant banking operations. Mr. Schulz is an NASD licensed series #24 Securities General Principal. He is one of the top securities fraud expert witnesses in the country and has been involved in over 400 securities-related disputes. He is a national lecturer and author and has been quoted in many respected financial publications.

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APPENDIX A**Sample Marketing Letter**

July 1, 1999

Mr. & Mrs. Andrew Parks
1111 South Elm Street
Anywhere, USA 00000

Dear Mr. & Mrs. Parks:

Thank you for relying on ____ (your firm) ____ for your accounting needs. You may be unaware that our firm is also a Registered Investment Adviser and offers financial planning and investment services to new and existing clients.

The main reason for this letter is to introduce you to our Investment Analysis Service, which supplements your current investment relationships—be they with a stockbroker or money manager. It can also assist you if you manage your own money.

The Investment Analysis is extremely beneficial, especially to investors who do not have extensive knowledge of investments or to investors who are too busy to properly monitor and evaluate their portfolios. At your election, once or twice a year, we conduct an analysis of your portfolio using your monthly brokerage statements and trade confirmations. Our report can be specifically tailored to your needs. A typical report could include some of the following:

- An analysis of the costs and commissions you have paid over a certain time period and whether or not they are in line with securities industry standards;
- A performance analysis that includes how your portfolio has performed in dollars and percentages and a comparison to various investment markets;
- An analysis of the trading strategy being followed to assess whether it is proper from a return standpoint and the potential tax ramifications;
- An analysis of your portfolio's realized and unrealized capital gains/losses and development of a plan to maximize the benefits of changing or adjusting your strategy;
- A review of the management of the portfolio including an investment suitability analysis; and
- An analysis of the investments and trading patterns within the portfolio with an eye toward highlighting the potential risks of owning such investments.

A primary benefit of our service is that you can be confident that our report and advice are objective. We charge a fee for our services that is based on the time we spend on the engagement. We never receive commissions. We will call next week to see if you would like to set an appointment to discuss how our Investment Analysis Services can benefit you.

Sincerely Yours,

