



Evolutionary Wealth ManagementSM

Bridging the Trust Divide:

*Advisor Best Practices for
Communicating Value and
Discussing Fees*




About Evolutionary Wealth ManagementSM

Developed by State Street Global Advisors (State Street), Evolutionary Wealth Management is a program designed to enhance the quality of, and access to, practical wealth management research and intelligence for financial professionals. Evolutionary Wealth Management reflects the dynamic nature of the wealth management industry, providing a forum for research on the full gamut of wealth management concepts. From financial planning and sophisticated investment management topics to discussion of fiduciary responsibility and complex trust and estate vehicles, State Street empowers advisors through the delivery of a knowledge-based platform that addresses the wealth management challenges advisors and their clients face today.



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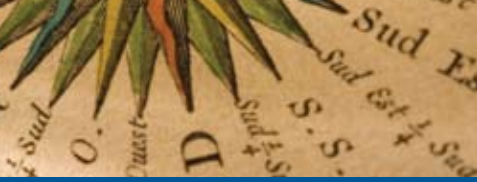


At one time, financial advice usually came folded into another service, sometimes in the form of suggestions from a tax accountant, more frequently in the form of stock tips offered by a broker-dealer. Often, it was good advice. At times, however, it was conflicted, because moving particular products sometimes took precedence over doing what was right for the client.

Over the last 15 years, that model has changed. First, advances in technology and regulatory reforms led to the rise of discount brokers, making it difficult for the old-fashioned stockbroker to sustain the same fee structure. Later, partly in response to that assault, the financial services industry looked to develop a more stable and less cyclical revenue stream. This fit in neatly with consumer concerns about conflicts of interest and has led to a new paradigm in financial advice—the movement toward offering consultative services instead of product pushes and straightforward fee structures rather than complex or opaque ones.

In this report, State Street and Knowledge@Wharton look at how financial advisors are negotiating the boundaries of this evolving relationship. Specifically, the report examines how advisors can:

1. Strengthen relationships by engendering trust;
2. Best communicate the value they bring to their clients given how clients generally perceive value; and
3. Successfully discuss fees with clients.



be hurting their credibility by not emphasizing their expertise enough. In Part II of this report, both a survey and a focus group conducted by State Street and Knowledge@Wharton found that there is a sizable gap between the value consumers place on expertise and the value advisors place on it. Additionally, and perhaps not coincidentally, a similar gap was found between how well clients think their advisors are doing and the advisors' much higher opinion of their own performance.

But how do you convey expertise to a non-expert? Croson says burying the investor with talk about means and standard deviations isn't the way to do it. Neither will the remark: 'Just trust me.' What's needed are explanations that are clear and yet not overly simplistic. As with a doctor or lawyer, insists Croson, the financial advisor consumers prize most is the one who can tell them just enough about the subject.

TRUST IN ETHICAL CONDUCT AND CHARACTER

While many advisors tend to think of trustworthiness as simply a function of personal and/or industry ethics, Rachel Croson believes consumers distill this level of trust into one basic yet critical question: "Do I trust you not to steal money from me?"

...increasingly the value of financial advice is not really managing the money, but in the "softer" advisory elements—personal counseling and instruction.

And this is precisely where an advisor's reputation comes in. Consumers tend to look well on advisors who are associated with companies that they have heard of. Advisors who belong to one of the 10-15 financial service companies that are household names may have an edge with many clients, according to Eric Bradlow, a professor of marketing at Wharton who teaches marketing strategy to financial advisors. Marketing professor David Reibstein points out that most of the advertising from the big financial firms is focused simply on establishing the firm as part of what marketers call an "evoked set"—the group that consumers consider when they think of a given category.

TRUST IN EMPATHIC SKILLS AND MATURITY

The final element of trust focuses exclusively on the interpersonal relationship. Dr. James Grubman, one of only a handful of specialized psychologists who provide wealth counseling and training services to financial professionals and their clients, confirms that there is a third dimension of trust present in every successful advisor-client relationship. This level of trust, which we might call relationship competence, may be the most critical because without it, as Grubman points out, the relationship is extremely fragile. Essentially, this trust is built on the client's premise that "if I tell you personal things about myself or my family, I need to trust that you, the advisor, will handle that well."

Grubman points out that because wealth brings unexpected stresses to many individuals and families, coping with money issues can be difficult. Many advisors struggle with the skills needed to solve the interpersonal issues associated with wealth management. Grubman's bottom line: clients are more comfortable and more likely to continue their relationship with advisors who are able to integrate the financial and the personal into their financial advising practices. Those advisors who don't, will likely face limitations in the advisor-client relationship and may find that they are ultimately unable to satisfy the client. Without the personal dimension, or without the client's trust in the advisor to handle personal issues and sensitive information with empathy and tact, the client will not feel connected to the advisor. Consequently, the advisor is often unable to get to the heart of a client's financial situation—the personal issues that underlie one's relationship with money.

According to Richard Marston, professor of finance at Wharton, increasingly the value of financial advice is not really managing the money, but in the "softer" advisory elements—personal counseling and instruction. "The advisor has to understand the logic behind the advice and work the argument through with the client so the client really understands it."

Clients are looking for advisors whom they trust enough—a trust grounded in the rapport established—to make difficult decisions for them. Barbara Kahn, a professor of marketing at Wharton, conveys the need is similar to what people are looking for in their doctors. In several research projects on how consumers make high-stake decisions in health care, Kahn found that while consumers are good at identifying the most important factors to consider, such as quality of life, survival rates, and cost, they tend to have a hard time putting those

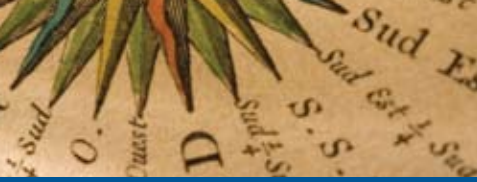
factors together on one weighted scale or in a single rule. That's where a trusted advisor comes in: in one of her surveys, only 15% of respondents said they would be comfortable making a trade-off on a difficult health care choice for themselves, but 61% said they would be comfortable with their physician's use of a similar model.

Kahn notes that similar results were found when consumers were asked to make hypothetical financial investment decisions. Since the choices that need to be made in financial advice are similar to health care issues in that they are often unpleasant or difficult (such as saving money versus spending it now, or taking on additional risk versus accepting a lower return), her theory is that people want to find someone who can make those kinds of choices for them. "Because they're stressful and not fun to think about, they would rather ask a financial agent to make those decisions," she says.

HOW ADVISORS CAN DAMAGE TRUST

Even once trust has been established between the client and the advisor, other variables can serve to compromise the relationship. As with any relationship, advisors must understand that trust is not a fixed quantity and is easily diminished. Weak investment returns might seem like the biggest way in which clients lose confidence in their advisor. However, Wharton's Bradlow contends advisors tend to underrate the importance of professionalism among every person on the team of staff supporting the relationship.

In fact, Bradlow suggests that often times only 15-20% of the client's contact is with the financial advisor; the other 80% of the contact is with the advisor's assistant and support staff. Those people are likely to have a very large impact on the client's opinion of the advisor's brand.



Bradlow argues that professional, well-trained support staff are essential, especially with a relatively new client. It can take between six months and a year for people to form a solid sense of an advisor's persona and brand, and that image can be shattered if multiple sources of contact introduce a view that is somehow incongruous or inconsistent with what the advisor has presented.

FUZZINESS ABOUT FEES

Fees are another critical area where trust can be easily diminished. The challenges the industry faces with fees are well-documented, but the results of the State Street / Knowledge@Wharton survey suggest that the credibility of many advisors may be hurt simply because of the way they are discussing their compensation.

In fact, the survey results (see Part II of this report) suggest that many advisors find fees a difficult subject to discuss. And they're not alone. Z. John Zhang, a professor of marketing at Wharton agrees: "In all service industries, nobody really wants to talk about the prices. You want the customer to focus on the service you provide and the results that you can deliver. I think for financial advisors it's the same."

Ironically, although advisors may try to skirt the issue of fees, leading financial advisors interviewed for this report say that most of their clients aren't all that concerned about the absolute levels of the fees. What they are concerned about is clarity. This isn't surprising: financial advisors and marketing experts at Wharton suggest that for most people, the issue isn't really whether fees are high or low, but that they know what they are.

Yet, despite years of negative publicity and controversy, some Wharton scholars are skeptical that consumers are getting as much clarity as they desire from the

financial services industry. "The most important thing is transparency—so people know what is going on unequivocally—and I'm not sure that that's happening," says Leonard Lodish, a professor of marketing at Wharton.

Fuzziness about fees seems to be endemic at every stratum of the market. Even the ultra high net worth investors, who presumably are getting the most sophisticated advice money can buy, are not satisfied with the degree of transparency they are getting from their advisors, according to a recent Institute for Private Investors (IPI) survey.

Charlotte Beyer, CEO of IPI, reveals that in the most recent survey of members in her organization—who are generally worth \$50 million or more—a large majority felt that while they believe the advice they receive is objective, they are concerned that they are not getting quite the full story about the fees they pay for the service provided.

In particular, she says, many members of her organization explain that the way advisors present their fees often makes it very difficult for the investors in her group to assess whether one firm is charging more than another. While the intent of such bundling is to keep clients from seeing the service as a commodity, Beyer argues that the practice is ultimately corrosive to the relationship. "If I don't feel that I completely understand the fee structure and I'm not sure I can compare one firm against the other...it puts a little chink in the trust I have." And once that trust begins to erode, she adds, the client becomes increasingly vulnerable to being snagged by a competitor.

When attempts are made to clarify fee structures, advisors shouldn't discount the potential for confusion or a lack of

understanding of what the fees mean on the client side, either. In a recent study¹, former Wharton professor of business and public policy Brigitte Madrian and two colleagues gave MBA and undergraduate business students prospectuses for four index funds. One group received an additional “fee sheet” that compared the fees and their impacts on earnings across the four funds, and another group received a “returns sheet” showing each fund’s average annual returns since the fund was started. The participants were then asked to make hypothetical investments of \$10,000, choosing among the four index funds.

Since the funds were identical, the only difference between them was the fees. What Madrian and her colleagues discovered, however, was that the participants “overwhelmingly failed to minimize the index fund fees” by neglecting to put all of their money in the fund with the lowest fee. The students who received the fee sheet did better than the others, investing more money in the lower-fee funds. “What we draw from this is that disclosure matters,” Madrian says, “but how information is disclosed also matters.”

Beyer predicts that this kind of fuzziness over fees won’t be around forever. “If you think about a lot of other things that you pay for—if you go to buy a car, you know what the blue book says, you know what the sticker price is. Increasingly, financial services are going to become more and more transparent,” she says.

TRANSPARENCY IN FEES

THE RISKS OF TRANSITIONING TO TRANSPARENCY

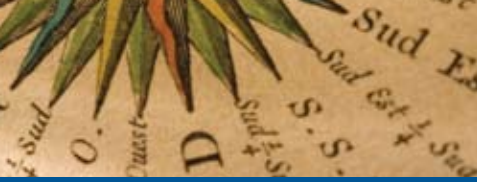
This lack of transparency in fees has helped make many advisors much more vulnerable than they realize, claims Mitch Anthony, a Minneapolis-based consultant to the financial advisory industry. “No matter how much you think you realize the level of distrust over fees, we underestimate it. It’s easy for the industry to say we’re changing the way we do business because we want to build trust with our clients, and then come out with a bunch of touchy-feely ads, but all it does is increase the level of cynicism to the consumer.”

Already, some experts believe that the pressure for more transparent pricing is pulling the market in two directions. “I think it’s increasingly barbell-shaped,” says Wharton’s Marston.

The winners, say Marston and others, are increasingly either advisors who offer custom service (typically on a percentage-of-assets basis) or cheaper, almost automated solutions, utilizing some of the increasingly popular low-cost index fund families and exchange traded funds (ETFs). The losers in the market are those who haven’t adapted to a world

“If you think about a lot of other things that you pay for—if you go to buy a car, you know what the blue book says, you know what the sticker price is. Increasingly, financial services are going to become more and more transparent.”

¹ Choi, James J., Laibson, David I. and Madrian, Brigitte C., “Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds” (May 2006). NBER Working Paper No. W12261 Available at SSRN: <http://ssrn.com/abstract=905518>



divided between providers of higher-fee, custom-tailored services and inexpensive solutions geared for the mass market. “The people who rely on current sales of stock and so on are having problems,” insists Marston.

Much of the industry is already proceeding on this theory. Many wirehouses, for example, have developed both online and full-service options, with the intent of trying to reach both ends of the market. Others have responded by making acquisitions, either of discount brokers at one end or trust service providers at the other, to reach the full spectrum of the market.

Another sign that financial services firms are aware of this change is that their training programs are evolving. At one time, Marston adds, advisors were taught how to sell a stock or a bond, and not much more. “Those days are over,” he says. “These firms are becoming much more sophisticated in their training.”

To make sure that their advisors are going to be able to satisfy the increasing demands of their high-end clients, a number of firms are spending enormous amounts of money educating their advisors, according to Marston. Some of the largest firms are even paying for tuition that will enable their financial professionals to earn a professional credential, such as a CFP (Certified Financial Planner) designation, he says.

RATIONALIZING THE FEE STRUCTURE

In courting new clients, the shift to a fee-only model is a challenging one for firms and advisors alike, professors say. One of the biggest hurdles is learning to articulate to the client what services they are actually getting in exchange for their fee or for an annual percentage of assets. This may be particularly the case in high-end accounts, if the advisor is no longer picking the stocks,

but picking managers. If that’s the case, what is the advisor actually adding? One way to address this issue, Marston contends, is to create rigorous methods for choosing managers. “It’s a much more serious business than it used to be,” he says.

But what if the advisor is just buying index funds or ETFs, which the client could buy through a broker relatively easily and cheaply? How can the advisor justify the right to an annual percentage of assets for as long as that relationship continues? Easily, in Marston’s view. He believes that there is actually a lot of value being created by the advisor even when nothing is happening in the portfolio. “My belief is that the number-one source of value added is getting the client into the portfolio and keeping them invested through different market cycles,” he says.

A lot of evidence supports Marston’s view that many investors need to be kept from acting on behavioral biases. “It’s well known that people think they are better at basically doing anything than they actually are,” maintains Wharton’s Croson. Investing is no different.

At the same time, advisors shouldn’t be afraid to alert their clients to the mistakes they may be making within the self-directed portions of their portfolios. This type of consult can provide the advisor with an anecdote that assists them in legitimizing their fees. A study conducted by Wharton Professor of Insurance and Risk Management Olivia Mitchell and several co-authors further illustrates the consequences resulting from investors not managing their portfolios actively enough. The study found that the average 401(k) account contains only 3.5 funds out of what is on average a set of 18 available funds—and 80% of the sample never traded at all over a two-year period. In fact, average turnover for a professional is about 117% while among the faster-trading 401(k) subscribers, it’s more like

24%. While that is undoubtedly better than daytrading, such ultra-low turnover may carry its own set of risks: “For the overwhelming majority of retirement savers, there is no evidence of portfolio rebalancing, shifts in risk tolerance with age, or tactical portfolio changes.”²

A trusted advisor can also add value by framing investment choices around a manageable number of options, because the evidence indicates that individual investors have a difficult time when faced with too many choices. A study of the investment choices of 857,000 employees of 657 different companies found that participation declined as the number of funds offered by their 401(k) plans grew. For every ten option increase, participation in the program declined by 2% on average, despite financial incentives to participate.³

One factor that Glenn Frank, a senior investment strategist for Calibre Advisory Services, Inc., a unit of Wachovia Wealth Management, of Waltham, Massachusetts, keeps in mind is that for some clients, convenience is a major reason they send their money to be managed by someone else. It’s similar to how they might feel about plumbing, suggests Frank, who in 2006 was ranked as one of Worth Magazine’s 100 top advisors: “Gee, I can do my own plumbing, but I’d probably get all wet and I’d pay more for parts.”

However clear the need for an objective, non-emotional advisor may be, Marston concedes that clients may not like the idea that they are really buying a kind of financial caretaker. “The client is not going to be willing to pay a fee for tying the client’s hands,” Marston says. Therefore, in creating the perception of value, he argues, many advisors find it easier to convince clients that they are adding value by choosing good managers—though conventional wisdom indicates that the vast majority of actively-managed large cap funds underperform the index.

Framing value in this way has its obvious limits. Today’s investor is becoming more and more sophisticated, both in terms of his access to investment research and his ability to manage a portfolio, which means that proposing that the primary value an advisor brings to a relationship is that of manager selection may not work over the long term. Advisors need to move toward offering their clients a consultative approach to financial management—one that blends the financial aspects of the relationship with the personal.

In this way, with the right communication skills and tools, the advisor adds real value by focusing not only on a client’s financial well-being, but on the underlying personal and familial issues that could further promote or cripple the client’s financial health. These are often the issues a client is unaware of, or reluctant to face, due to anxiety or embarrassment. Experts and the State Street / Knowledge@Wharton survey suggest, however, that an advisor who is able to build and preserve trust on all three levels—competence, ethics and empathic skills—is in a better position to help clients face these issues head-on and create more satisfying and long-lasting relationships with them.

Part II of our report offers empirical evidence on precisely what financial advisory clients are looking for from their advisors. The results may be surprising to some, but they reinforce what Wharton professors and other industry experts believe—that clients want straight talk from a trusted professional.

2 Mitchell, Olivia S., Mottola, Gary R., Utkus, Stephen P. and Yamaguchi, Takeshi, “The Inattentive Participant: Portfolio Trading Behavior in 401(k) Plans” (2006). Available at SSRN: <http://ssrn.com/abstract=881854>

3 Sheena Sethi-Iyengar, et al., “How Much Choice is Too Much? Contributions to 401(k) Retirement Plans,” *Pension Design and Structure: New Lessons from Behavioral Finance*, 83-95. Oxford: Oxford University Press. (2004)



II. What Advisors Know—and Don't Know—About Their Clients

Although clients desire clearer communication from their advisors, the findings of a survey of financial advisors and, separately, affluent individuals, conducted for this report found that many advisors' relationships are much shakier than they believe.

The survey, conducted by State Street and Knowledge@Wharton to assess the strength of the client-advisor relationship, revealed a material gap between advisors' perceptions about their client relationships and the clients' perceptions of those relationships. While people are notoriously likely to discount the importance of emotional factors such as congenial personality in their choice of professional relationships, this discrepancy may still be a cause for concern for advisors and for the marketers of advisory services—particularly as clients surveyed rated advisors' performance about half as highly as advisors themselves believe their clients rate them. And that may place some advisors at risk.

Key findings of the research follow:

FEES ARE AN AREA OF MISCOMMUNICATION BETWEEN ADVISORS AND CLIENTS

FIGURE 1

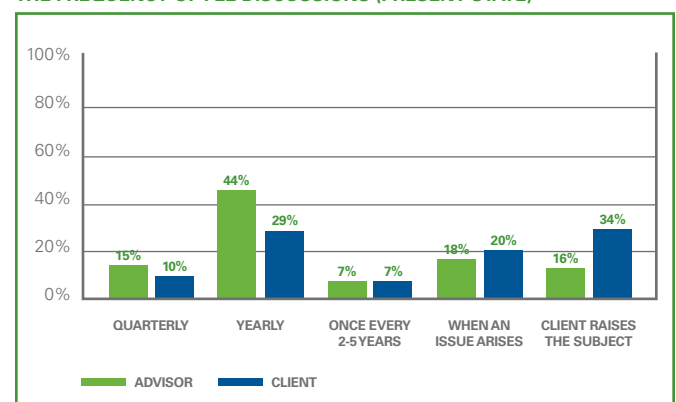
In both the focus group and the survey, fees were revealed to be an area where there is a wide gap between what advisors say and what their clients hear.

The actual degree of communication advisors and clients have about fees is unclear. Almost all advisors surveyed (95%) indicated they discuss their fees with their clients; yet, only 66% of customers say that their advisor initiates fee discussions with them.

Why the gap in perception between advisors and clients on the issue? Bradlow believes it's wishful thinking on the part of advisors who are uncomfortable discussing

fees. "It's almost like they want to believe that this is something that's understood. If you believe that it's already been covered, then you don't have to do it."

**FIGURE 1: COMMUNICATION ABOUT FEES:
THE FREQUENCY OF FEE DISCUSSIONS (PRESENT STATE)**



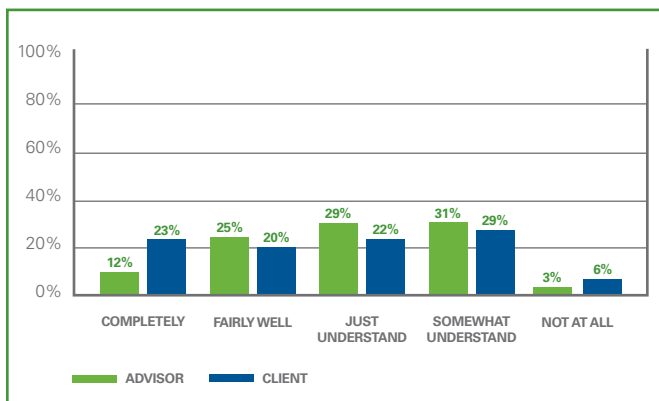
For a graphical depiction of the complete set of raw survey results, visit www.spdretfs.com or call 877.521.4083.

Ironically, although advisors presumably don't discuss fees out of fear of scaring away clients, the clients who participated in a State Street focus group agreed that they would prefer knowing. "I have more of a problem with not knowing," said one woman.

FIGURES 2 & 3

Perhaps as a result of this lack of contact, only a minority of advisors surveyed believe their clients understand their fee structure fairly well or completely. Clients confirmed that they generally do not understand their advisor's fee structures all that well.

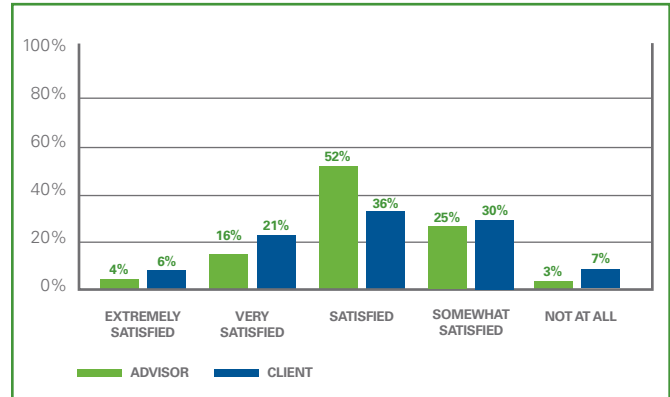
FIGURE 2: UNDERSTANDING THE FEE STRUCTURE: HOW WELL DO THEY UNDERSTAND?



Most advisors said they believed their clients felt that they were receiving a fair value for the fees they paid. Most clients are, in fact, relatively satisfied with the value they receive for the fees they pay, but generally less so than advisors think.

In addition, costs matter much more to clients than advisors believe. A striking 41% of advisors believed that cost was their clients' least important concern. Although still the lowest-ranked factor, reasonable cost was believed to be an important aspect (rated as one of the top two most important attributes) by 31% of clients.

FIGURE 3: RECEIVING FAIR VALUE FOR SERVICES PROVIDED

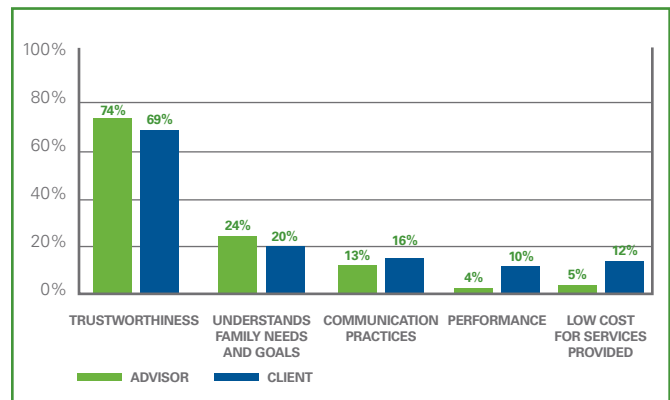


TRUST IS ESSENTIAL

FIGURE 4

Among advisors, more than two-thirds ranked trustworthiness as the most important attribute in the selection of a financial advisor. For clients, trust is also the key element (69%).

FIGURE 4: THE IMPORTANCE OF TRUST: MOST IMPORTANT CHARACTERISTICS OF A FINANCIAL ADVISOR



KNOWLEDGE IS MORE IMPORTANT THAN ADVISORS THINK

FIGURE 5

Another discrepancy between advisors and clients is the different weight they place on knowledge. While only 26% of advisors ranked knowledge as a top attribute, nearly half of all clients gave it their highest rating.

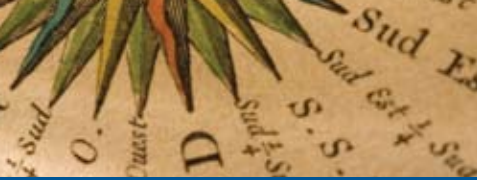
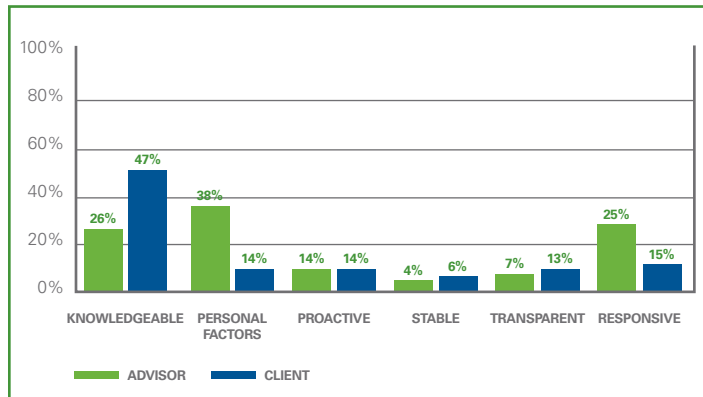


FIGURE 5: THE IMPORTANCE OF KNOWLEDGE: THE MOST IMPORTANT ATTRIBUTES TO SERVING CLIENTS WELL



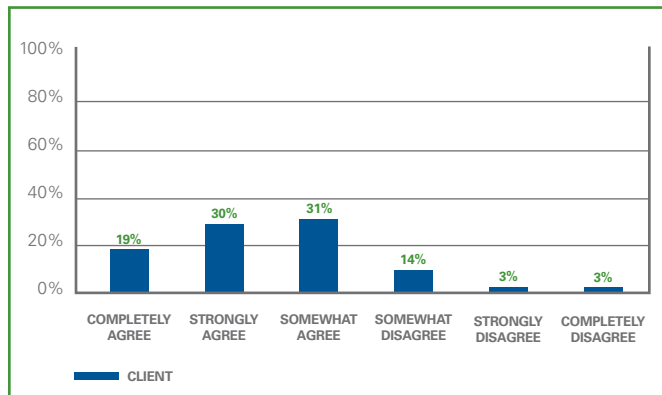
Some members of the focus group also saw competence as extremely important—and ignorance as nearly a deal-breaker. In the focus group, for instance, one woman who was asked to sell some holdings before she moved her account to a new firm, said that she was unable to get her new firm to tell her what the tax consequences of the sale would be, not even an estimate. “I wasn’t really able to get any clear answers,” she says.

CLIENTS BELIEVE THEIR ADVISORS ARE OBJECTIVE—TO A DEGREE

FIGURE 6

Most clients are not entirely satisfied with the advisor’s degree of objectivity. Perhaps this is an indication that, for most clients, their level of trust in their advisor is not absolute, especially as it pertains to the fees or commissions the advisor collects.

FIGURE 6: DEGREE OF ADVISOR OBJECTIVITY



BUT ADVISORS DON’T HAVE MUCH TIME TO QUELL CLIENTS’ DOUBTS

FIGURES 7-10

One challenge for advisors in correcting some of these preconceptions is that their clients don’t actually want to communicate more with them than they already do. The burden, then, is on the quality of the communication and not necessarily the quantity.

FIGURE 7: CURRENT FREQUENCY OF COMMUNICATION

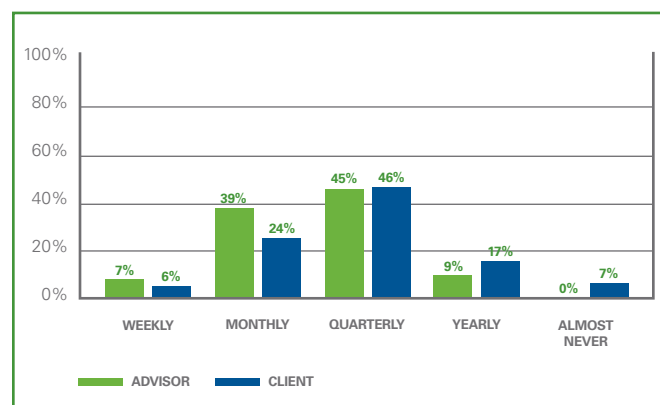
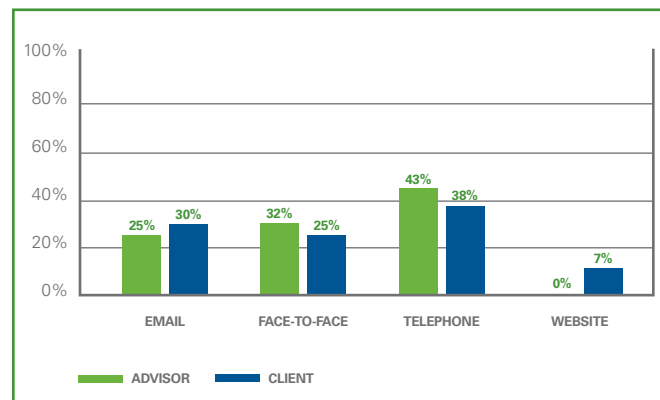


FIGURE 8: COMMUNICATION MEDIUM CURRENTLY EMPLOYED



While some advisors would prefer meeting with their clients a little more often, clients don’t actually want more contact. In general, a few more would like to hear from their advisor on a monthly and quarterly basis.

FIGURE 9: DESIRED FREQUENCY OF COMMUNICATION

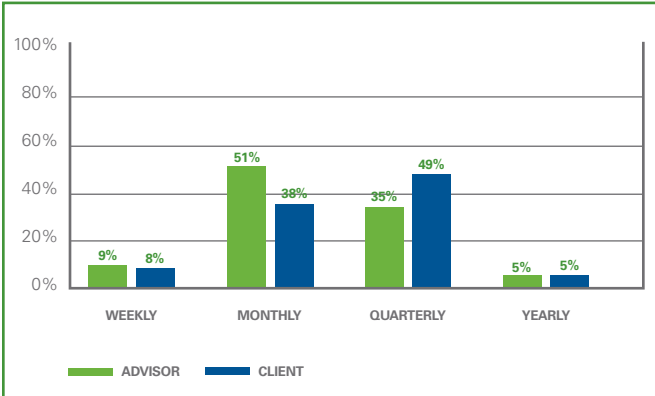
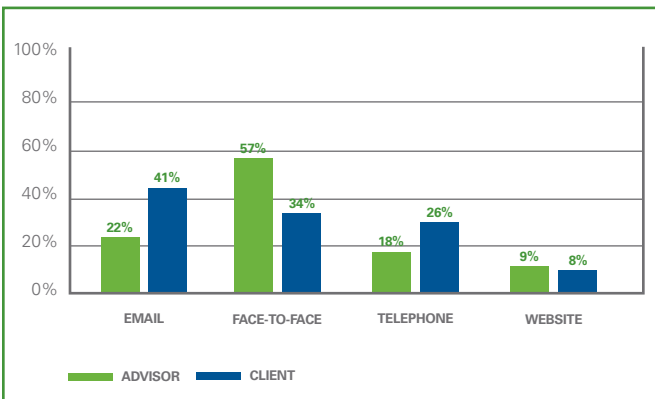


FIGURE 10: DESIRED COMMUNICATION MEDIUM



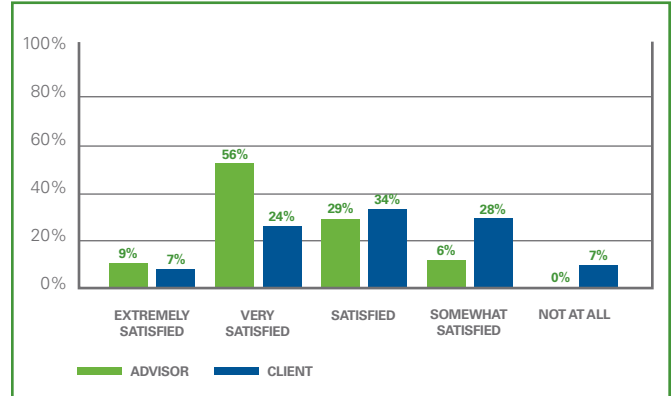
An interesting divergence exists in that advisors’ preferred face-to-face communication, even though clients preferred email.

Advisors and clients do share one area of agreement when it comes to communication: Clients don’t like hearing from their advisor via a website any more than the advisor wants to share information through that medium.

INVESTORS ARE MUCH LESS SATISFIED WITH THEIR ADVISORS THAN THEIR ADVISORS BELIEVE THEM TO BE
FIGURE 11

Perhaps as a consequence of the deviating perspectives noted above, clients are less happy with their advisors than advisors believe them to be.

FIGURE 11: CURRENT LEVEL OF OVERALL SATISFACTION WITH ADVISOR

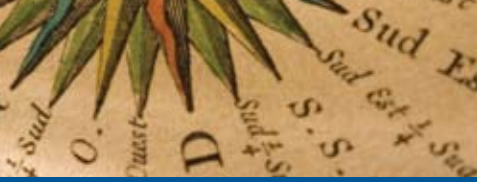


Most advisors believe their clients are either very satisfied or extremely satisfied with their service. Yet, the survey found that clients are actually much less happy with their advisors.

How hard advisors are working to correct such faults seems to be a matter of perspective. Advisors are much more likely to say they have asked their clients how to improve their relationship than clients say they do. *In fact, 70% of clients reported that they had not been asked how their advisor might improve the relationship.*

“There’s a massive gap between what clients think and what advisors think,” concludes Bradlow. He says the data reminded him of market research on companies where the focus is on the product rather than the customer. “These are the classic percentages of a product-centric company as opposed to a consumer-centric company,” he says.

In a product-centric company, most of the emphasis is on the products, rather than on making sure that the products are actually designed around the needs of a customer. Many consumer product companies have made this transition, but Bradlow believes financial services is further behind.



If the survey is reflective of general attitudes, many clients feel disconnected from their advisors. Instead of ignoring clients once they've signed on, Anthony believes advisors should tell them that "part of my value proposition is that I'm going to pay attention to you."

The results of both the survey and the focus group suggest that advisors need to think about their clients more on an ongoing basis. As one participant in the focus group said, "The fact is, I work too hard to put my money with someone who doesn't care."

Ultimately, for advisors, increasing the level of transparency and clarity in communications will help build trust and improve their ability to develop productive, long-lasting and satisfying relationships with clients. The next section of the report focuses on a best practices method for discussing fees that can help advisors to build trust early on and throughout the relationship.

RESPONDENT DETAILS

A total of 866 individuals completed the State Street/Knowledge@Wharton online survey, which was held between June 14 and June 29, 2006. Two identical survey tracks (i.e., lines of questioning) were presented to each group, which included: (1) 500 consumers and (2) 366 financial advisors. Financial advisors comprised a wide range of investment and financial service professionals, and clients represented an equally wide range of portfolio sizes.

ADVISOR RESPONDENTS. Of the advisors, 42% of respondents were providers of financial or wealth management services; 30% worked for a private wealth management firm or a private bank; 28% were financial planners; and 16% worked for a wirehouse. Sizes were also divided almost equally between large (32%); small (25%); and boutique (29%). The only underrepresented segment was advisors at mid-sized firms (14%).

Advisors represented a surprisingly broad cross section of the business. Median account size for the overwhelming majority of respondents was \$5 million or less. Respondents again were divided almost equally between accounts of less than \$500,000 (33%); accounts of \$500,000-\$999,000 (30%); and accounts of \$1 to \$5 million (25%).

Among the 360 providers, 58% charged a percentage of assets, 21% charged a fee plus commission. Eighty-seven percent said they did not collect any performance fees. The remainder was divided almost equally between flat fee (5%); commission only (6%); and flat fee by project (10%). Bundled fees and unbundled were about

equally divided—53% to 47%, respectively. A majority said that their fees were negotiable. Thirty-eight percent said that they were negotiable for all clients, but 44% said that negotiability depended on asset size. Only 18% said that their fees were never negotiable.

CUSTOMER RESPONDENTS. Client respondents were equally divided between people who used private banks or private wealth management firms (33%); financial planners (28%); or broker-dealers (27%). More respondents worked with large providers (49%) than was represented in the advisor's sample.

Most respondents paid for financial planning/wealth management on a percentage of assets basis (42%), but commission only was also popular (23%). Fees are bundled for most of them (62%). Few negotiated their fees with their advisor (74% did not).

More consumers had portfolios of less than \$500,000 (48%), but more were over \$5 million than represented on the advisor side (6% reported portfolios of over \$5 million). The remainder fell into the \$500-999K (20%) and \$1 million to \$5 million (26%) categories. Most didn't pay performance fees (71%) or didn't know whether they paid a performance fee (22%).

FOCUS GROUP. A focus group of affluent investors who had responded to the survey was moderated by a professional moderator. The discussion was held in New York City in July 2006.



III. Advisor Best Practices: Building Trust with the Fee Discussion

Years of perceived conflicts of interest have made some consumers suspicious that their financial advisors are truly there to help them. As the survey and the focus group results demonstrate, some clients are in fact alienated from their advisors. “I’ve gotten to the point where I listen to their spiel, but not really, because I really just don’t believe it,” said one participant in the focus group.

As for fees, it’s clear that nobody wants to talk about them; but experts and the survey propose that there is a high price to be paid for avoiding the subject. They say a lack of transparency about fees negates trust on all levels. Bradlow says that the survey suggests advisors may even talk themselves into thinking that they have discussed fees enough, when in fact they haven’t. Dr. James Grubman, psychologist and consultant to wealth managers and high net worth families, concurs that many times advisors avoid fee discussions due to their own anxiety about the outcome. So, what is the right way to talk about fees with prospects and clients?

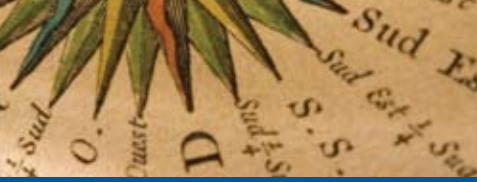
The successful advisors interviewed for this study affirm that the clearer and more direct the advisor is about fees, the better. “Talking about fees isn’t always the most comfortable thing, but if you say it as a matter of course and that’s the fee, clients are usually pretty accepting,” states Glenn Frank.

Among ultra high net worth investors, this already seems to be the case. “My experience with investors and financial professionals is that, increasingly, a discussion of the business model is beginning to be held at the beginning of the courtship,” says, Beyer of IPI.

Frank also tries to keep fee discussions very clear. “I like to put them all out on the table including our own potential conflicts, and I like clients to be really pragmatic in their search.” He also has them ask the competition some key questions: What’s your retention rate? How many clients do you actually serve or try to serve? What’s your performance?

Frank says he always tells prospective clients, “Either we’re the best or the second best choice for you. The other choice is themselves...They could go out and put together an array of index funds and do it themselves, and the cost would be less. *“They generally appreciate the candor,” he says.*

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Candor has paid off for Frank in more direct ways as well. Frank relays that once he even had a client ask to be given a higher fee, after he had first inquired about a fee reduction. “We can do a lower fee,” Frank told him, “but you’re probably not going to be the first call that I answer.” In response, his new client changed his mind and said he’d pay more. “You get what you pay for—and he wanted to get more, so he paid more,” Frank recalls.

If possible, most successful advisors interviewed believe a single, simple fee schedule is usually the best way to go. Besides appealing to clients, that kind of simplicity pays other dividends as well. Jeannie Gibson Sullivan of Back Bay Financial Group in Boston, remembers that at one point, her firm offered 13-15 different fee structures. Now they have one, on a single sliding scale. “It’s a lot simpler and it’s a lot easier to automate.”

To help ensure that the client is perfectly clear about the fees, Patrick Carrigan, a senior investment management consultant at a major wirehouse, reveals that his team has put together a visual graphic which depicts a complete breakdown of precisely what the client pays for each service. In this way, Carrigan is able to illustrate transparency by delivering an itemized breakdown of the services and fees charged. Clients have really responded well to the information, he adds. “It’s been extremely well received. It’s one of the most powerful things we’ve done—it defuses the fee question right off the bat.”

Very often, Carrigan also raises the issue of compensation. Without outlining the fee schedules offered by his closest competitors, Carrigan simply tackles the issue of compensation by discussing the various fees and compensation models that are employed by a wide range of wealth management firms.

FOUR STEPS TO SUCCESS WHEN DISCUSSING FEES

According to Dr. Grubman, there is a lesson to be learned from these advisors’ approaches. He firmly believes all advisors have it within their power to replicate the success of Carrigan and others. “It’s a matter of developing procedures that really work,” says Grubman. Just as doctors can be taught how best to deliver difficult news to a patient, he says, so too can advisors be taught how to best talk about fees. “The discussion about fees has at least four components to it. If you don’t follow these pieces, it can go badly. If you follow all the components, then it goes well,” says Grubman. He describes a recipe of sorts for the fee discussion, identifying the active ingredients necessary for successful conversations about fees that foster client trust.

1. DON’T PROCRASTINATE

One key ingredient is to simply disclose. Advisors would do well to tell clients what their fees are in as straightforward a manner as possible. “The reality is,” says Grubman, “many advisors are really nervous about this.” They fear that they will be put in the position of having to deal with a negative or contentious response from the prospect or client. He often finds that advisors don’t tolerate their own anxiety all that well and this causes them to avoid the fee discussion as long as they can.

“If I don’t tell you how many basis points I’m going to charge,” says Grubman, “we can’t fight over it. If I do tell you, you might want to fight, and I don’t know how to handle that. So instead I’m going to avoid the whole thing.” The advisor’s discomfort with assertiveness is a huge issue in communication skills.

In pointing to Carrigan’s approach, Grubman notes “Just simply the fact that the firm didn’t avoid and dealt with it openly is an active ingredient. They didn’t procrastinate. They didn’t avoid. They did it—they disclosed.”

2. DESCRIBE FEES WITH CLARITY

Setting up fees simply and describing them clearly is a critical second ingredient, asserts Grubman. “Advisors often mess this up, because out of their own anxiety or their own issues about fees, they will obfuscate. They think that they are being specific in showing all the shades of gray with fees. In reality, clients do not want shades of gray. They want it pretty black and white.”

For many reasons, advisors often get incredibly detailed when it comes to describing fees. Instead of clearly stating a fee of 70 basis points, for example, they’ll talk about the ranges in fees they charge for various types of clients. They may then further cloud the fee discussion by talking about an array of special circumstances that may or may not drive further modifications in fees. Though the advisor may be well-intentioned in doing so, Grubman says that offering an excessive variety of contingencies actually erodes trust. What advisors perceive as detailed disclosure of shades of gray, explains Grubman, “is experienced by clients as loopholes, fudging and being untrustworthy.” Intricately detailed fee menus just contribute to ambiguity and generate mistrust, warns Grubman, so communicate fees directly with clarity.

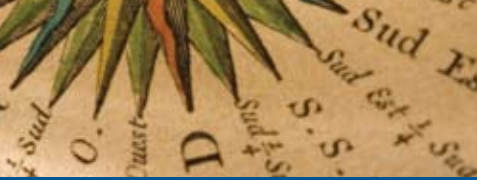
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3. PROVIDE CONTEXT—BENCHMARK FEES

Providing clients with context by benchmarking your fees, says Grubman, is the third step to success in the fee discussion. Investment professionals are immediately able to convey trustworthiness and credibility by providing clients with relational information about fees. Successful fee discussions occur when the advisor presents his fees in comparison to what competitor fees and/or the average industry fee costs. This is useful “because if I know that the range of offerings typically is somewhere between 0.95% and 1.5%, and you quote me 1.25%,” says Grubman, “at least I know we’re in the range.”

Advisors are acutely aware of industry fee schedules and what their competitors may be charging. However, many wealthy individuals do not know whether a fee being charged “is good, bad or indifferent,” according to Grubman, and that is unsettling for them. Money and the fees charged for money management are not a water-cooler topic of conversation for most wealthy clients. For a host of reasons, people can be rather secretive, preferring not to talk with friends or acquaintances about their wealth or what they pay for services. Context is key, according to Grubman, particularly for those clients who are working with a trusted advisor for the first time.

Market research demonstrates that embedding information in context actually conveys more than if you deliver data without context. Grubman points to the Energy Efficiency Rating on appliances as an example of how context adds value. The efficiency rating conveys not just what the estimated annual operating cost is of the appliance you’re thinking of purchasing, but also a comparison scale of that appliance against other models and brands. It shows you exactly where your appliance falls within the full range of possible ratings, giving the consumer a much better vantage point from which to evaluate the product.



ENERGY EFFICIENCY RATING



Comparison scale of appliance against other models and brands

Estimated annual operating cost

There are ultimately a huge number of ways advisors can communicate fees to clients these days. The ideal manner, contends Grubman, would be to very clearly present up-front what the typical industry rates are for the advisors type of firm, for a client’s particular net worth, or for a specific category of client, etc. As Grubman points out, advisors who are adept at the fee discussion don’t just tell clients what their firm’s fee is—they present the fee in context with the range of fees industry-wide. “Yes, this is scary,” recognizes Grubman. “You may have to justify your fee to the client if it is on the high side. But, ultimately this is better than hiding behind a lot of figures and then having the client find out later anyway.”

“So when we talk about what my fee is compared to others, I’ve told the client many things. I’ve said ‘Look, I’m honest. Look, I’m consistent with industry rates.’ Plus, I’ve educated you,” states Grubman. By providing the client with information in context, he says, the advisor conveys trustworthiness and provides real value to the prospect or client.

4. PUT IT ON PAPER—GIVE CLIENTS SOMETHING TO REFER BACK TO

Finally, advisors would do well, Grubman adds, to put their information about fees in writing, because generally people don’t retain information all that well in a face-to-face meeting. “We know people simply don’t remember half of what goes on,” he says. So, what an advisor says to a client is almost never what the client walks away remembering.

This phenomenon explains both the discrepancy in perceptions about fees revealed by the survey, and also where mistrust can sneak into the relationship. An advisor may know he told a client the fee was 90 basis points with one exception. The client remembers it as 90 basis points, no exceptions. Both parties, then, begin to think that the other is being untruthful or trying to get away with something should a disagreement arise.

Grubman points out that there are a lot of lessons to be learned from the medical field and that a host of similarities exist between the advisor-client and doctor-patient relationships. In the medical field, for instance, a lot of procedural training takes place around how to prescribe medications. Doctors are being trained to ask patients to repeat back instructions regarding when and how to take their medications, for the reason that patients simply do not retain information well.

The reason certain methods, like Carrigan’s, work is because the advisor provides a chart or visual that the client can take home with them. “So if they forget or they’re not sure, they can refer back to something and say, ‘Oh, yes, that’s right, they said it [the fee] was 1.25%.’”

If advisors want people to retain important information in detail, says Grubman, they must write it down: “Written and visual lasts. Oral and verbal flies away.”

FOCUS ON THE PROCESS, NOT THE FINAL CONVERSATION

Ultimately, where many advisors fail in building trust about fees, says Grubman, is by focusing only on the end of the discussion—or on the confrontation they fear will ensue once they tell the client what the fee is. “Everybody is focused on that last segment of the conversation,” says Grubman. “In actuality, if you haven’t done the component pieces the correct way leading up to that point, how are you going to have that last [bit of the] conversation? It’s liable to go wrong in a zillion ways.”

According to Grubman, competence in the fee discussion can be achieved easily when there is a well-defined, repeatable roadmap for the conversation.

According to Grubman, competence in the fee discussion can be achieved easily when there is a well-defined, repeatable roadmap for the conversation. By following the aforementioned steps, which are independent of who the client is, says Grubman, advisors build trust and place themselves in a more capable place from which to address client-dependent variables, such as the client’s personality or situation in life. That is the bottom line in the relationship: responding well to a client’s concerns, states Grubman. Here is where the advisor must be equipped with the communication skills so integral to the “relationship competence” discussed earlier.

CONCLUSION

Ultimately, the financial advisory business is changing and becoming more transparent. Wharton experts, as well as those like Dr. Grubman and successful financial advisors themselves, say that this way of doing business is better for the client as well as the advisor, in that it tends to build a stronger, longer-lasting relationship. But as the State Street/Knowledge@Wharton survey suggests, doing business in this way may require unlearning behaviors and attitudes, and acquiring new methods for communicating effectively and openly with clients. “What is needed,” states Grubman, “is a paradigm shift. And it’s happening.”

In a world where investment solutions and services are becoming increasingly commoditized, experts agree that, for advisors, the extent to which they can act as trusted counselors and educators to their clients will be the real differentiator or measure of value. And the surest way to build trust, according to Wharton faculty and other industry experts, is by demonstrating through one’s actions and words competence in three critical areas: knowledge, ethics and perhaps most importantly, interpersonal communications.



IV. Acknowledgements

Thanks to the Wharton Faculty, many advisors and industry experts we interviewed for this report. Their insights were invaluable. Specifically, we'd like to acknowledge the following individuals:

- Jack Abrams, *Jack Abrams Financial Management*
- Mitch Anthony, (*mitchanthony.com*)
- Charlotte Beyer, *Institute for Private Investors* (*www.memberlink.net*)
- Patrick Carrigan, *wealth advisor*
- Glenn Frank, *Calibre Advisory Services, Wachovia*
- Jeannie Gibson Sullivan, *Back Bay Financial Group*
- Dr. James Grubman
- Nestor Vicknair, *Merrill Lynch*

A special thanks to Dr. James Grubman for sharing his time and knowledge with us. For more information about Dr. Grubman's work with wealth managers and high net worth investors, visit www.jamesgrubman.com.



Published by State Street Global Advisors and Knowledge@Wharton at The Wharton School of the University of Pennsylvania.

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