

Praise for *The Professional Financial Advisor*

The financial services industry and the role of the financial advisor along with it are in a hyper state of evolution. To be candid, advisors who do not make the shift from “salesperson” to “professional” in regard to the scope of their services and the role they play in their clients’ lives will find themselves on the outside looking in. *The Professional Financial Advisor* is an excellent resource, worthy of shelf space in advisors’ offices across North America.

—Dennis Moseley-Williams, Consultant, Pareto Systems

A growing number of Canadians are concerned about the sorry state of investment counselling in this country, but it has taken a rare breed of bird—an insider with a conscience—to both identify the problems and propose solutions. John De Goey’s book may not win him too many friends among advisors [...] but it will earn him thanks from small investors who, for too long, were convinced that somebody was picking their pockets. De Goey not only names the pickpockets, he identifies the best methods of eliminating them.

—John Lawrence Reynolds, author of *The Naked Investor*

Increasingly, consumers are seeking real value from their financial advisors. Consumers want a transparent partnership founded on trust and full disclosure. Separating financial advice from financial products provides benefits to both parties. John De Goey repeatedly illustrates how the “professionalization of financial advice” is a winning position for everyone. He demonstrates how prudent and knowledgeable advisors can save consumers time and money through this common-sense strategy. Consumers and advisors imperil their success if they avoid this profitable trend.

—Dale Ennis, Publisher, *Canadian MoneySaver*

The ongoing health of any industry or organization is enhanced by periodic self-assessment, even when the results of that review are not always kind. John De Goey has presented a probing critical assessment of the world of financial planning, along with his passionate prescriptions for what ails it.

—George Hartman, author of *Risk Is Still a Four Letter Word*

In expressing his views about the tenets of truly professional advice-giving, John De Goey has steadfastly maintained a point of view that has raised the ire of some but should be of interest to all advisors and the investors they serve. De Goey deserves credit for stoking the flames of debate on such controversial issues as the structure of advisor compensation and the integrity of professional advice.

—Darin Diehl, Publisher, Executive Editor, StockHouse.ca

Advance praise for *The Professional Financial Advisor II*

Many talk and write about fees but often forget the other parts of the equation: value provided in return and professional standards. John De Goey hits the nail squarely on the head. The candour and passion with which he presents and discusses these issues is refreshing.

—Dan Hallett, CFA, CFP, President, Dan Hallett & Associates Inc.

You don't have to agree with everything John De Goey says to concede that he plays in a higher league when it comes to ethics and doing what is right for the client.

—Rob Carrick, the *Globe and Mail*

A wise, provocative, and well-written book. It makes a convincing case that success comes from the application of the sound principles of professionalism.

—David H. Maister, author of *True Professionalism* and co-author of *The Trusted Advisor*

John De Goey's insights into what he terms "embedded compensation" and compensation biases made an important contribution to the development of the Fair Dealing Model and the articulation of the FDM and its goal to eliminate futile regulatory requirements while promoting true professionalism in the financial service industry.

—Julia Dublin, Barrister and Solicitor, Alyesworth LLP

There are a number of distinct schools of thought on how securities are priced and traded on the secondary market. For example, value-based analysts, technical analysts, and efficient markets proponents all make different assumptions about the usefulness to investors of different types of company, economic, and market information. It is important for an investor to understand these differences and to select the approach that reflects their views. This book provides some useful insight on security pricing.

—Eric Kirzner, Professor and John H. Watson Chair in Value Investing, Rotman School of Business, University of Toronto

John De Goey is the consumer's friend because he raises issues that many advisors don't care to address—issues like how advisors are paid and why there isn't a consistent education standard for advisors. An educated consumer is an informed consumer. *The Professional Financial Advisor* is required reading before turning your life savings over to an advisor.

—Deanne Gage, *Advisor's Edge*

John De Goey effectively updates us with tremendous insights into the plight of the financial services industry and the unbundling of sales from financial advice. In particular, his unique perspective on the development of financial planning as a profession is not only interesting but also extraordinarily relevant.

—Cary List, COO, Financial Planners Standards Council

The **P**ROFESSIONAL
FINANCIAL ADVISOR II

The **PROFESSIONAL**
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How the financial services industry hides the ugly truth

John J. De Goey

MPA, CIM, FCSI, TEP, CFP



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The opinions expressed are those of the author and not necessarily those of Burgeonvest Securities Limited. The opinions and generalizations by the author concerning professionalism within the financial services industry reflect the lack of homogeneity among numerous providers of financial services from differing industries (insurance, banking, financial planning, and investment) and with differing standards of conduct. For advisors who are regulated by the Investment Dealers Association of Canada, some of these generalizations about professionalism are not accurate.

With respect to opinions relating to modern portfolio theory and passive versus active management, an attempt has been made to discuss these complex academic issues in simple terms. As such, the discussion does not fully reflect the breadth and depth of opinion and evidence regarding these topics, nor can it be expected to. Everyone's investment and retirement plans must be created to satisfy their particular situation. Therefore, it is recommended that the reader treat the information in this book as general in nature and consider getting advice from lawyers, accountants, financial planners, and other related professionals.

For Sophie

Contents

Introduction	13
Part One: Preparing FSPs	21
Becoming a Profession	23
Preparing FSPs	34
Inefficient Markets	58
Efficient Markets	62
Education or Indoctrination?	86
Part Two: Scientific Testing	107
Get an Investment Policy Statement	109
Scientific Testing	121
Investment Pornography	136
Behavioural Finance	141
Eliminate the Bias	157
Parts and Labour Sold Separately	167
Part Three: Necessary Disclosure	189
Necessary Disclosure	191
Ramifications of Unbundling	218
What Adds Value?	228
Get Advice If You Need It	245
What Can STANDUP Advisors Do?	253
Do-It-Yourself Advice	265
STANDUP Insurance Advice	272
Part Four: Professionalism	297
Be a STANDUP Advisor	299
Ethics, Professionalism, and Change	315
Notes	338
Acronyms	340
Recommended Reading	343
Index	346
Acknowledgements	351
About the Author	353

Introduction

In the three years since the first edition of this book was released, there has been only moderate progress in the Canadian financial services industry. We still have a balkanized regulatory framework and consumers still have very little meaningful recourse when it comes to restitution for wrongdoing. Judging by industry scandals, one might also conclude that the unsavory elements of the industry will likely continue to do things “the old way.”

Then again, consumers and advisors are growing increasingly fed up with the status quo. A growing number of leading-edge advisors are doing what they can within their own practices to respond to a growing demand for professionalism. Some of those attributes that are lacking in many advisory relationships are becoming key differentiators. Matters such as transparency, the alignment of consumer and advisor interests, independent academic research, and a clearer focus on cost are all coming to the fore. Up to now, part of the problem has been the lack of suitable products and platforms: it’s pretty difficult for advisors to move to a more professional paradigm if the industry is still predicated on a culture of sales.

This edition has been updated, but since the first edition was based primarily on advocacy for the future, there wasn’t a whole lot to do. Updating factual data is not why there’s a second edition; finding new approaches to old problems is the purpose of this new edition.

The real change in *The Professional Financial Advisor II* is in its focus. In essence, while the first edition was a challenge that called for a revolution, the second edition is more of a guide that describes an ongoing evolution within financial services. This

approach seems more suited to the world we live in. People who know me know that I prefer to take a positive view. As such, this edition also aims to be more of a light and less of a judge regarding stakeholder behaviour.

Speaking of evolution as opposed to revolution, the continued evolution of the three trends I spoke of in the first edition are clearly continuing: the “all things considered” approach (called *convergence*) seems to be taking hold as the prevailing paradigm for advice; the idea of charging for financial advice after removing product compensation (called *unbundling*) is definitely gaining momentum; and the trend of some people doing things for themselves but with specialized oversight (called *disintermediation*) is alive and well too. This latter trend can be seen as the Home Depot mindset of personal finance: “You can do it. We can help.” The trends of convergence, unbundling, and disintermediation are all at work as the financial services industry works to distinguish between those who merely sell products and those who add value through professional advice.

As with the first edition, I’ll continue to lump all advisors and planners together with traditional brokers and salaried employees and call them all Financial Service Providers, or FSPs.

The creation of a true profession will involve a variety of factors. In fact, there is still some uncertainty about what the salient attributes of professional financial advice should be. Unlike the first edition, which was heavy on detail and targeted people in the business, this book is less prescriptive and focused more on the ordinary consumer. The goal of getting all stakeholders on the same page remains unchanged, but this time there is a real effort to show how consumers and FSPs can work together to effect positive change for everyone.

Although certain challenges to the status quo are still present, the emphasis now is on looking at what the best FSPs are doing in order to capitalize on trends—for both their own sake as well as their clients’.

The lack of progress is due largely to self-regulatory organizations (SROs), advisory firms, and product manufacturers, all of which have vested interests they would prefer to protect. Taken together, I’ll refer to these stakeholders as “corporate interests”

throughout the book. Essentially, the corporate interests of the financial services industry, while never referencing certain things explicitly, cause people (FSPs, consumers, journalists) to think and act in a certain way. It is an approach that has allowed corporate interests to prevail at the expense of other stakeholders.

The existence of “asymmetric information” means that ordinary consumers often end up as victims of circumstance. When the laypeople are only given part of any story, it’s difficult to imagine them making wise decisions. Astonishingly, there are considerable gaps in the knowledge base of most FSPs too. Corporate interests have a way of getting what they want by inference and innuendo. This is quite insidious and highly deliberate, since it leads to larger profits (for both product manufacturers and distributors) and fewer lawsuits (for SROs and the firms they represent).

Consumers and FSPs generally do what they think ought to be correct, even though the industry seldom comes out and explicitly says what that is. Many FSPs are too entrenched in defending a value proposition (that of picking stocks or picking people who pick stocks) to ever become the truly independent professionals they aspire to be. Employers perpetuate this value proposition further.

If you want more background on how corporate interests maintain dominance, I recommend you either read Joel Bakan’s book *The Corporation* or watch the documentary of the same name. If you want to get a quick sense of what insiders with a social conscience go through, you may want to rent the movie *The Insider* and focus on the challenges faced by Russell Crowe’s character. It is the corporate element of the financial services industry that is doing the most to impede progress.

The key intermediary in all of this is the FSP, who is conflicted in trying to serve two (or more) masters. As former OSC Executive Julia Dublin has said, FSPs are the “ham in the sandwich” of the industry. Many FSPs find themselves caught in the middle, wanting to do what is right for their clients, but brought to heel by the tyranny of mortgage payments and the need for job security. Stakeholders that are fat, happy, and extremely profitable within the status quo are hardly likely to embrace any change that threatens those attributes. Not all FSPs will be able to recognize the prob-

lem. Fewer still will be able to act in their clients' best interests even if they do recognize the inherent conflicts.

It will take a rare breed of FSP—a “STANDUP (Scientific Testing And Necessary Disclosure Underpin Professionalism) Advisor”—to cut through the noise to get to the heart of the problem. The encouragement of all advisors to follow the lead of a few trailblazers and be STANDUP Advisors offers a vision that many believe is both desirable and inevitable.

There's an acknowledgement in this edition that FSPs are by no means a homogeneous group. For greater clarity, I have chosen to compare and contrast the practices of the best advisors (STANDUP Advisors) with those of the advisors most entrenched in the status quo for reasons of self-preservation, or “SPANDEX (Sales Pitches And Non-Disclosure Eliminate eXcellence) Advisors.”

It's easy to tell the difference: STANDUP Advisors do what is best for their clients, while SPANDEX Advisors serve corporate interests. Like the material they are named after, SPANDEX Advisors are both flexible and highly durable but not particularly valuable. They need to be done away with, but their durability is a significant part of the problem. Many (probably most) FSPs are neither; I simply use STANDUP and SPANDEX as extreme ends of what is ultimately a fairly wide spectrum.

There are a number of STANDUP Advisors who are tired of waiting for the industry to voluntarily transform itself into a profession. Rather than wait, they've decided to forge ahead— and good for them! However, they are facing an uphill battle because corporate interests, SPANDEX Advisors, uninformed consumers, and much of the media have lined up against them. Collectively, consumers, consumer advocates, and STANDUP FSPs are up against a monolithic industry that is well entrenched, self-satisfied, and highly profitable. The industry has no motive to morph into a profession, in spite of whatever rhetoric you may have heard to the contrary.

In light of such pervasive and well-financed opposition, how can STANDUP Advisors possibly hope to succeed? For one thing, sunshine is the best disinfectant. This book focuses on two attributes of professionalism that almost no one would dare to chal-

lenge: Scientific Testing And Necessary Disclosure. The acronym *STAND* was used briefly in the first edition, too, but I wanted this edition to be more proactive and empowering regarding positive change. I chose the acronym *STANDUP* to make a clear statement against the inertia that good FSPs have endured and to put a clear emphasis on real professionalism.

I'm encouraging all FSPs to act like *STANDUP* Advisors in the hope that consumers in turn will appreciate the gesture and reward those FSPs who accept the challenge with more and better business relationships. I believe consumers will gravitate toward *STANDUP* Advisors once they understand the problem. Change can come either by having FSPs voluntarily change their behaviour (which is highly unlikely, given what they are up against), or by forcing corporate interests to change their behaviour (also unlikely).

Many FSPs can see and read the evidence and decide for themselves how to offer advice. The most important thing is that FSPs ultimately become professionals—the “how” is secondary.

I also wrote this edition to help consumers get more from the FSPs they work with. In order to do so, they'll need a fuller understanding of the biases that corporate interests put into the business and that are such a pervasive part of financial services in the first place. Critics have suggested that I am anti-advisor. What nonsense! I am decidedly in favour of quality advice. I am also on the side of consumers, empirical evidence, and disclosure. Any FSP who cannot differentiate between conflicted advice that favours corporate interests and unbiased advice that favours consumers is clearly part of the problem. I am decidedly in favour of *STANDUP* FSPs and opposed to *SPANDEX* FSPs. As I said earlier, FSPs are by no means a homogeneous group.

This book will ask people to consider the value of both active management and financial advice. In both cases, readers are encouraged to either take it or leave it—depending on how they come down on each question—and there is evidence on both sides of both debates. Contrary to what many stakeholders would have us believe, the questions are mutually exclusive.

I am of the opinion that most FSPs add value and most active managers (i.e. people who actively trade stocks) subtract it. Many

FSPs have an identity that is wrapped up in a value proposition tainted with corporate motives, making it difficult to extricate the value proposition of quality advice from the value proposition of security selection.

Many financial services companies maximize profits on the assumption that active management adds value. While the evidence on this is sketchy, there can be little doubt that the use of active management enhances the corporate bottom line.

Unfortunately, most people are unaware of the evidence in favour of a more passive investing approach. To make matters worse, the media, aided and abetted by an army of SPANDEX Advisors, has led consumers to equate active management with financial advice, and passive management with a do-it-yourself (DIY) approach. Again, this is a facile simplification. These determinations can *and should* be reached independently.

At issue here is the notion of value for money. When it comes to stock picking, price and value can be quantified fairly reliably. Conversely, the value of good advice is much more difficult to measure in a meaningful way. At any rate, these are separate decisions where one conclusion ought to have absolutely no bearing on the other. Many people, especially members of the media, make an unnecessary link, suggesting that passive investing is for do-it-yourselfers and active investing is for those working with an FSP. Worse still, many SPANDEX FSPs buy into this joined-at-the-hip line of thinking.

Going forward, the question of genuine independence will be seen as the critical missing link in completing the transition from a culture of sales to a culture of professionalism. The industry's compensation models clearly undermine the principle of independence. It may well be that the biggest change that has to occur is the total eradication of embedded compensation. People who offer financial advice want desperately to be seen as independent champions of their clients' best interests, even though many currently feel in their hearts that they aren't. I firmly believe that most FSPs have good intentions.

There are a number of advocates across the country who want meaningful consumer protection, and for all the right reasons too. In other words, those pressing for change are generally more con-

cerned with societal welfare than personal gain, but to date, advocates have been too few and too poorly organized to get real results. Many share the assessment that corporate interests are a major part of the problem.

On the flip side, if a consumer's situation is exceedingly simple or the FSP is not genuinely adding value, firing that FSP and pocketing the difference may well be the best thing to do. The decision to use or forgo using an FSP should be no different than the decision to use or forgo using an accountant. It is largely personal and situational.

I believe most people would be better off with a qualified FSP, but I also believe that there is a considerable minority that could do quite well without one. For those people who would be better off acting as their own advisors, they should be given every opportunity to do so with regard to both investment and insurance products. No matter how valuable quality advice may be, it is the height of arrogance to suggest that good advice is so universally useful that everyone should be forced to pay for it whether they want it or not.

The fundamental premise of this book is that *real professionals provide services that are in their clients' best interests*; a sales motive should never compromise a professional advisory role.

There's nothing wrong with sales as a calling in life, it's just that the term "professional salesman" is a virtual oxymoron. As the profession evolves (led by STANDUP Advisors), the sales representatives (SPANDEX Advisors) will need to be shown the door. Until then, the ugly truth is that we're dealing with a perverse kind of conspiracy, a conspiracy of ignorance so secret that the co-conspirators don't even know about it themselves!

When I was in graduate school, a professor of mine suggested that the term "change agent" was really a sanitized corporate euphemism for "shit disturber." I fancy myself as a change agent in the best sense of the term. If we're not purposeful, the industry might fall short of transforming itself in ways that are in everyone's best interest. I hope this book can be a constructive touchstone for what needs to happen as part of this change.

We have a fabulous opportunity to transform the financial advice channel into an integrated, holistic and bona fide profes-

sion, complete with all the trappings of other professions. The industry can be recognized as such only when the concerns raised in the pages that follow are addressed.

Throughout this process, there are a number of questions that will need to be resolved. What might the financial services landscape look like in the future? More to the point, what *should* the industry look like? Perhaps most of all, readers should consider what they believe the hallmarks of a qualified *professional* Financial Service Provider ought to be.

Paying transparently for genuine professional financial advice will require everyone to rethink both the role of the FSP and the value of that advice. The transition will be challenging, but it has to come. We need societal recognition that rendering comprehensive financial advice can and should be transformed into a professional activity in every sense. Perhaps we can call it the “world’s youngest profession,” even if many people think its credibility today is on par with the “world’s oldest profession.”

We have some very real and deep-seated problems that need to be addressed. In the end, politicians, regulators, FSPs, consumers, the media, companies, and industry associations will all need to voice their concerns in a dialogue on the creation of this new profession.

Until now, much of the discussion has not involved apples-to-apples comparisons of business models, services rendered, product recommendations, or the alignment of interests. Many hurdles need to be cleared before the associated respect and confidence accorded to any true profession can be won, but there can be no doubt that an evolution toward a more forward-looking and client-centred profession is clearly under way.

John J. De Goey
Toronto, August 2006