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Investment ADVISOR

How Lew Wallensky gets more out of less time with his clients

Michael Fasciano: You may not know his name, but you should

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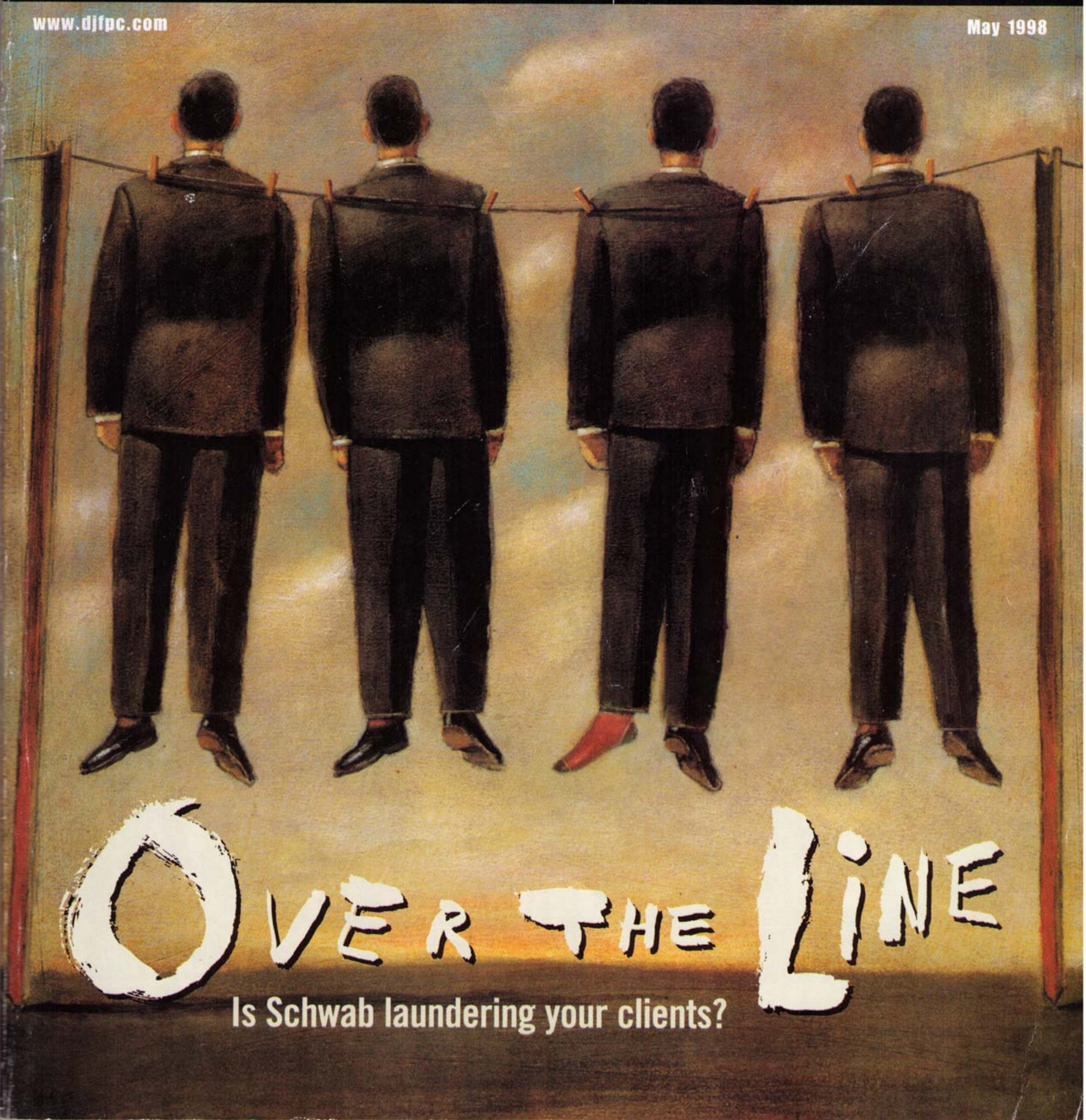


EMPTY

Do Schwab's attempts to fix the recurring problem of "out

MARJORIE MEYER, A CPA WITH A SMALL INVESTMENT MANAGEMENT practice, was on vacation in Florida last Christmas when she called in to check her messages. Someone named Kevin Casey from Charles Schwab's Chestnut Hill branch outside of Boston had called. He left a message asking why one of her clients who had recently opened an account of several hundred thousand dollars had transferred it all back to Merrill Lynch. "I felt like it was none of his business," says Meyer, "and I ignored the call."

Six weeks later, Meyer learned that the call was only the beginning of Schwab employees meddling in her business. An employee at the Schwab branch had learned that Meyer was retiring, and employees called Meyer's clients, offering to put them in touch with investment managers enrolled in Schwab's AdvisorSource client referral program.

For Meyer, who was in the midst of selling her investment management business (on a standard earnout, based on retention of clients and assets), Schwab's interference was a

PROMISES

f bounds" client contacts address the real problem? By Andrew Gluck

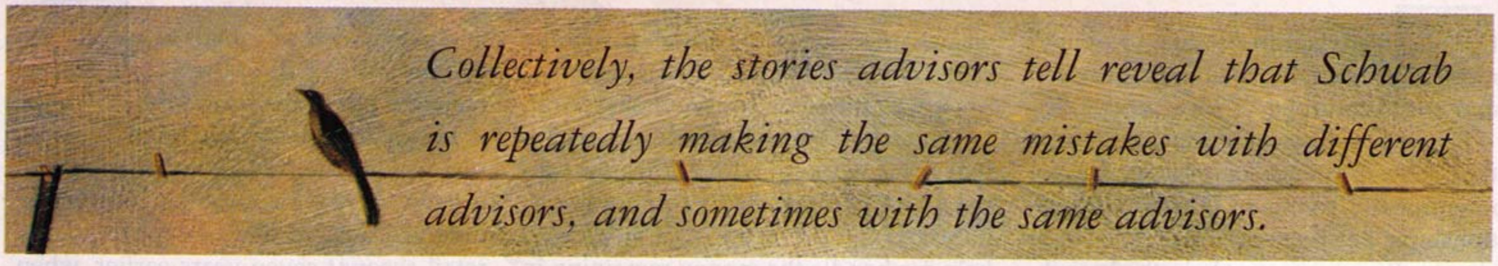
stunner: "They had begun to cannibalize my business."

Meyer immediately contacted Schwab management, who apologized, and put a stop to further contacts, which they agreed were inappropriate. However, when she took the matter further, demanding the records of those contacts, a formal apology, and damages, Schwab changed its tune, Meyer says, citing her failure to return Casey's original call as the cause of their actions.

Schwab concedes its branch personnel attempted to contact four of Meyer's clients by phone and reached two. Schwab spokesman Glen Mathison says, "It was a mistake." According to Mathison, "a miscommunication" led Schwab branch employees to believe that Meyer herself had told the branch she was retiring. Branch employees, he says, were simply trying to help Meyer's clients find other advisors.

The Meyer case is but a recent incident in a long history of independent advisors'

Illustration by Joseph Daniel Fiedler



uneasiness with Schwab Institutional, the firm that's played a leading role in the emergence of fee-only asset management. Charles Schwab Institutional's integrated back-office systems and easy-to-use software have made it the nation's largest custodian of independent advisor accounts, with $121.7 billion in advisor-managed assets. Many of the 5,457 advisors doing business through Schwab credit the company with helping them grow their advisory firms beyond their greatest expectations.

At the same time, Schwab is the largest discount brokerage for retail investors, with $285 billion of assets and more than 272 branches—more assets than any other fund supermarket. And Schwab is giving retail clients asset allocation and mutual fund portfolio advice.

No evidence suggests that Charles Schwab & Co. is engaged in a concerted corporate conspiracy to take clients away from financial advisors. But Schwab must walk a fine line in serving its Institutional advisors while it serves tens of thousands of retail accounts. It appears that Schwab is crossing that line more often than many advisors may realize. About one in three Schwab Institutional advisors contacted at random for this article said that Schwab had inappropriate contact with their clients within the past three years.

Each advisor's story in isolation seems like a fairly harmless mistake. And a Schwab executive almost always apologized and promised Schwab will never let a similar incident happen again. But collectively, the stories advisors tell reveal that Schwab is repeatedly making the same mistakes with different advisors, and sometimes with the same advisor, painting a picture of a firm that is working at least at cross-purposes to—and possibly with a different agenda than—financial advisors who "hire" Schwab merely to custody their clients' investment accounts.

Financial advisors have had concerns about Schwab's relationship with their clients for years. But in the middle of 1996, the issue came to a head, as advisors across the country were rankled by Schwab's announced plans to roll out a fund of funds and Schwab's perceived failure to communicate about retail initiatives advisors regarded as threatening. The debate led Schwab to form a "discussion group" with nine advisors it picked to air the problems.

After meeting with the nine advisors, Schwab released a 10 point "action plan" heralded in a July 12, 1996, press release as "outlining steps Schwab will take to meet the needs identified" by investment managers. Key steps in the plan included revision of the Schwab Investment Manager Service Agreement, a redesign of AdvisorSource, communication with advisors about Schwab's strategic plan, development of a 401(k) offering for advisors, and development of SchwabLink Web. The revised service agreement states: "Schwab has no intent to communicate with your clients except as may be required by law, rule, or regulation. . . . Schwab will use its best effort to limit its communication with your clients to those designed exclusively for Schwab Institutional clientele."

Schwab's action plan quieted disgruntled advisors. While some advisors still groused about Schwab competing with them, the 1997 Schwab Impact conference was no longer dominated by the controversy of the previous year, and the bitter rhetoric that marked those days in June 1996 has been absent—until Marjorie Meyer.

Details of Meyer's problems with Schwab surfaced on NAPFA-NET, the e-mail system of the National Association of Personal Financial Advisors. It reignited the debate about Schwab's relationship with advisors' clients. A handful of advisors reported that Schwab contacted their clients in ways they felt were inappropriate.

Some advisors wouldn't criticize Schwab if their name would be mentioned in this article. Schwab plays such a key role in their business that they fear reprisals. "I'm a fiduciary and have a responsibility to look out for the best interests of my clients," explains one advisor. "Criticizing Schwab publicly could ultimately hurt my clients."

But several advisors would tell stories about client relationships that were undermined by Schwab. For instance, one advisor in Florida says a client recently went into a Schwab branch office to find out about Schwab Online, the retail brokerage's Internet-based trading system that charges a flat fee of $29.95 to trade up to 1,000 shares of a stock.

"The client says he was told by the branch employee that to get the favorable commission rate, he would have to fire his advisor," says the planner. "He e-mailed me a note asking if I'm sure these guys are really my friends."

The advisor was obviously unhappy to hear this from a client. But he was also upset that the client could not get the low commission stock trade rates to speculate on some stocks in an institutional account that would be included with the rest of his assets managed by the advisor. "If my client wants to trade online, what's the difference whether it's done in an institutional or retail account?" asks the advisor.

A Schwab Institutional spokesman says the $29.95 is pricing for a retail customer only, and that "advisors get a whole different service offering. We have a dedicated service team and SchwabLink. The whole institutional offering is different. Therefore, we have a different pricing structure."

As you might expect, contacts advisors often find objectionable stem from activities at Schwab branches. "I used to view Schwab's physical presence as an advantage, and I would send clients to the branch to deposit securities or occasionally to pick up a check," says Elliot

Lipson, an advisor in Atlanta. "Not anymore. Their people are undersupervised and out of control."

Schwab spokesman Mathison says that Schwab branch employees are not intentionally trying to undermine relationships between advisors and their clients. "You have people in the branches who are trying to do the best they can for investors," he says. "They are clearly not supposed to be interfering with the relationships advisors have with their clients. Most, if not all, of our branch employees know that, but this is a relationship business involving human beings, and sometimes mistakes occur."

Indeed. Take the case of Bonnie Wolf, a novelist and screenwriter. Wolf and her husband are clients of Marc O'Brien, an investment advisor in Cambridge, Massachusetts. Wolf says that a year ago she walked into Schwab's Lexington branch with a check for several hundred thousand dollars that she wanted to place in a money market fund. Wolf explained to the clerk that she had recently sold her home and that she planned to use most of the money she was depositing to purchase a new home.

"He typed my name into the computer and saw that I had a number of accounts," says Wolf. "He said he knew that Marc O'Brien was my investment manager and asked me how that was working out and whether I was happy and whether I needed any help in handling the money I was depositing," says Wolf. "He asked if I wanted them to recommend someone else to help me with it."

Wolf found a new home a few months later and needed a check for a $20,000 down payment, so she went to Schwab's Burlington branch to pick up the check. She was escorted into a cubicle and gave the clerk her money market account number.

"It was the same routine," says Wolf. "I remember that he mentioned seeing that I was working with Marc after calling up my account on the computer, and he asked me if I needed an advisor to help me handle the money remaining in the money market fund."

Another sore point several advisors mention is Schwab retail's Delta Sky Miles bonus program. John Brown, an advisor in Fairhope, Alabama, says that early last year one of his clients saw an ad or received a flyer in the mail for the program and sent in her application.

A Schwab retail representative called the woman to confirm the information in her application and, according to Brown, "The Schwab rep told the woman she would have to terminate her relationship with her advisor. This woman didn't know there were two classes of Schwab customers," says Brown.

Brown says that in fairness to Schwab, the application the woman filled out included some "fine print" excluding Schwab Institutional customers. But he wonders why the Schwab reps sending out applications to individuals that call in don't ask if the applicant is a Schwab Institutional client—not an unreasonable question since nearly one of three dollars in assets held at Schwab belongs to a Schwab Institutional client.

"No client is going to leave me for Schwab, because of the service we provide," says Brown. "It's just the concept of doing business with a firm that doesn't seem to appreciate you when you have other options." Brown says the air miles incident followed an accidental mailing by Schwab retail to his clients, and he pulled half of the $22 million he manages out of the firm.

Lipson, in Atlanta, had a similar experience with the free air miles program. Lipson says the problem ironically involved a client that he sent to open a retail account seven years earlier, when he wasn't yet managing money. Last year, Lipson says, the client came back to him for advice and since he now manages money and keeps assets housed at Schwab, he directed the woman go to a Schwab branch with security certificates worth $300,000.

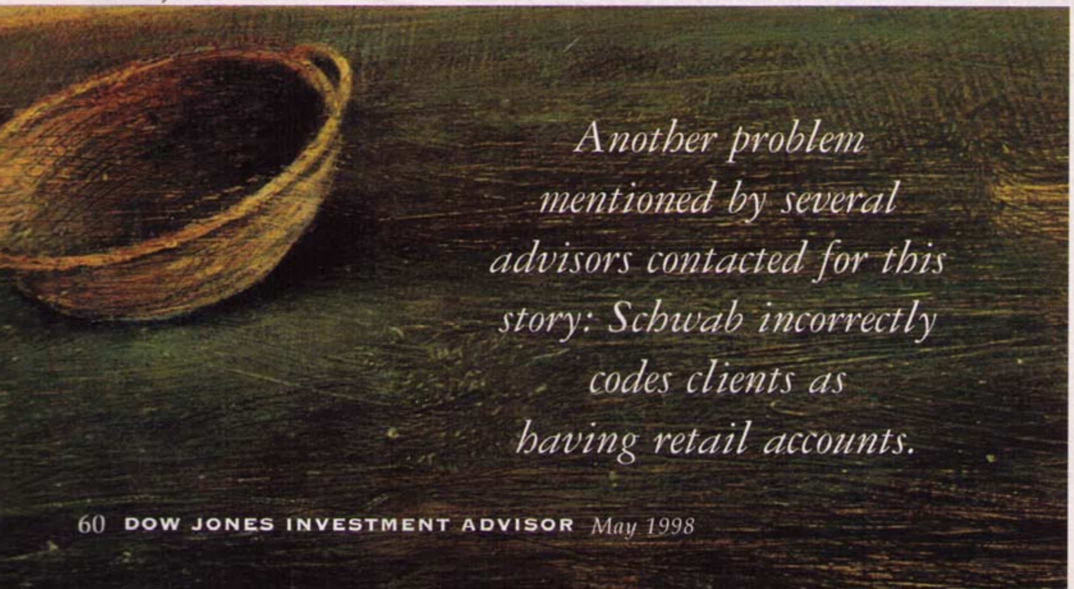
"The people in the branch directed her attention to the air mileage program, so she deposited the money in a Schwab retail account," he says. "I proposed to Schwab that they put the fund in an account that I would manage and that she also get the air miles credit, but Schwab refused and said it was only a retail promotion that could not be given to someone with an advisor's account."

Schwab's response to the Delta Sky Miles complaints from advisors appears to be uneven. An advisor in Massachusetts says clients who receive direct mail solicitations or see ads and request Sky Mile credits can receive them on one deposit. Other advisors say their clients have been flatly refused any Sky Mile credits because they don't have retail accounts. Sky Miles entitles Schwab retail customers who fill out an application to 3,000 frequent flier miles on the first $30,000 of deposits in a Schwab retail account. Additional credits entitle them to a total of up to 50,000 miles a year.

Asked about these incidents, Schwab Institutional Senior Vice President Gerald Graves says the uneven treatment of advisors on Sky Miles will now end.

"Delta Sky Miles is a retail program, but it's our goal not to cause problems between advisors and their clients in offering that program," says Graves. "So if an advisor comes to us with a conflict or problem, we will act appropriately, crediting the Sky Miles." Asked directly if advisor clients will be entitled to the same Sky Miles a retail client gets, Graves said yes.

Another problem mentioned by several advisors contacted for this story: Schwab incorrectly codes clients as having retail accounts. According to an advisor in



Maryland, his best client was contacted by a Schwab retail branch in March while he was away on vacation. The advisor says the branch employee was offering to help his client because he was under the mistaken impression that she had dropped her advisor. The advisor contacted Schwab Institutional's regional representative, who spoke with the branch employee. Schwab's explanation to the advisor: The client had filled out a new account form and did not check off the areas that are required for institutional clients.

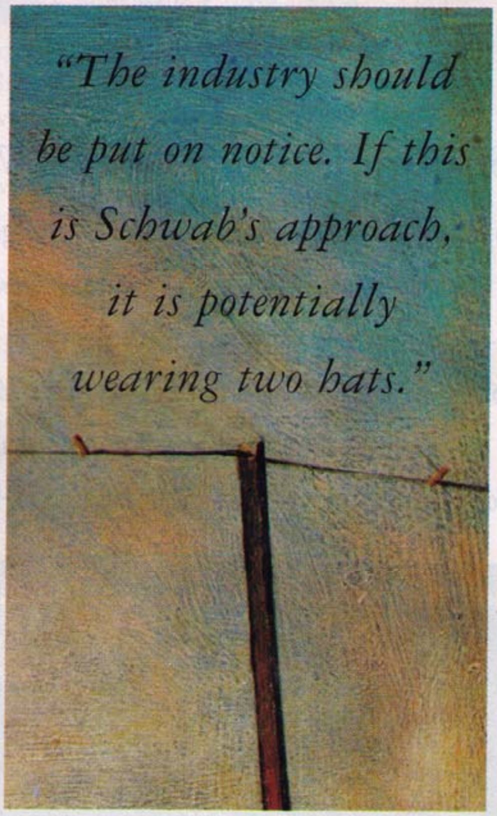
"That's absurd," says the advisor. "We fill out all the account forms for all of our clients and the only account forms we have here are institutional ones."

Jean Deighan, an advisor in Bangor, Maine, says that Schwab has always resolved the occasional miscoding error in a professional manner, and she praises the firm saying, "Schwab is good." Still, she says it was awkward when a Schwab rep contacted one client about Schwab's Value Advantage Fund. And it was embarrassing when a trustee of a $6 million retirement account received a letter confirming a transfer to a new money market fund and the branch offered to facilitate any phone transfers. "He was thinking that maybe he was supposed to be supervising me," says Deighan, who chalks up the errors as honest mistakes by Schwab.

One of Meyer's clients contacted by Schwab, a 42-year old attorney who did not want to be named, says the situation to her is clear: "Schwab perceives itself as having a business relationship with me." Ironically, she says she did not like the two advisors to whom Meyer sold her practice and she was happy when Schwab called to offer her an alternative. But, she adds, "The advisor industry should be put on notice. If this is Schwab's approach, advisors ought to know that. Schwab is potentially wearing two hats."

But while Schwab's dual role of serving both advisors and retail customers is undoubtedly a cause of some confusion, perhaps the real problem is something much simpler, as illustrated by what happened to Peter Langer, an advisor in Wilmington, North Carolina. Langer says that in early March he called one of his larger clients to let him know a sizeable transfer had hit his account. "It seems someone from Schwab already called to tell him the transfer had come in, and he asked my client if there was anything else Schwab could do to help him and whether he was interested in any other Schwab services," says Langer, "such as a Schwab OneSource account."

Langer handled the issue matter-of-factly with the client, but he was upset: "It was shocking to me." He called his Schwab Institutional regional representative, who patched the Schwab branch manager into the call. "Frankly, the branch manager didn't seem surprised or upset by the incident," says Langer. "He didn't seem to get it. He proceeded to tell me that the worst thing that could happen was that the money would stay at Schwab."



And therein may lie the real clue to this knotty problem: How can Schwab on one hand profess to respect the relationship between advisors and their clients, and yet on the other have so many instances where that respect has clearly been lacking? Perhaps because Schwab, in its corporate culture (which is pervasive all the way down to the clerks in the branches), doesn't really see accounts as retail clients or advisors' clients, but simply as assets—Schwab assets. And if advisors can bring in assets, or retain assets, that retail services couldn't, so much the better. And, of course, those advisors, as independent contractors, are free to come and go as they choose. But as with any successful brokerage house, Schwab's job, and that of its employees, is to retain assets under management. And should advisors show difficulty retaining those assets themselves. . .

Several days after Schwab was contacted for reaction to the charges made by advisors, a Schwab spokesman said the firm had sent an announcement throughout the retail system to correct such problems. "We announced to our retail operation that we had fixed the account tracking system used by our retail employees," says Mathison.

"The fix clearly flags institutional accounts with a 'do not call' coding next to the client's name and address, so we can quickly and easily help the branch employee avoid contacting advisor contacts. This is really key to making sure that we do not make outbound calls to clients of advisors."

Mathison says the announcement went to all the managers and business development employees in the branches, and they were asked to forward it to front-line branch personnel.

"We've been aware of this problem and have been looking for fixes," says Mathison. "It was clear to us that we needed to speed up this fix. Longer-term, we want to continue to look at this and how we can better record the wishes of our advisors and their clients so we are doing exactly what advisors want us to do and don't want us to do vis-á-vis their clients."

"A lot of advisors make use of the branches and want their clients to make use of the branches, so we just want to make sure our branches know who's who," he says. "All we can do is continue to make sure branches understand that they should not be stepping in the middle of the relationships advisors and their clients have and make sure they're aware of who they're talking to."

Mathison added, "This was directly related to the Marjorie Meyer problem."

Says Meyer, in reaction to the Schwab initiative: "I regard it with a large amount of suspicion. They are acknowledging that they've been aware of the problems all along, when they told me repeatedly that mine was an isolated incident and that they've never heard of this happening before. That's just spin." DJIA