The Which-Doctor Is In...

Take Our Compatibility Survey

A cardiologist walks into a patient's room and says, "you're going to need open heart surgery." At that moment, most of our minds would begin to race. One might wonder about the survival rate of the surgery. Our thoughts may shift to our loved ones, or we may have questions about the recovery time and how painful the ordeal will be. But how many people would wonder if the recommended surgery is of debatable necessity for the patient and financially advantageous to the doctor?

In the medical profession, performing a surgery for any motivation other than a patient's well-being would almost certainly mean losing the ability to practice medicine. The existence of explicit medical laws ensures that doctors act in good faith and do not allow their personal interests to conflict with their professional duty. The absence of such measures in the medical community would instantly shatter trust in the healthcare system.

Unfortunately, in the financial community there isn't a single standard of care that applies to all financial advisors. Instead, in the investment industry, there are two sets of laws and advisors can choose which they'd like to follow. In technical language an advisor is either held to a fiduciary standard or a suitability standard. In lay terms, this means one type of advisor must make recommendations they believe to be in the very best interests of the client. The other advisor must only be able to argue that is "suitable." Unfortunately, there's not much guidance as to what it means for something to be suitable, which is hardly reassuring for investors.

Evergreen Gavekal is an independent Registered Investment Advisor (RIA)[1] and is held to a fiduciary standard. "Brokers" aka financial advisors at UBS, Morgan Stanley, Goldman Sachs, Wells Fargo, Merrill Lynch, and other banks are held to the lower "suitability standard." Consider some recent quotes from prominent financial advisors who have ditched these banks and have instead opted to become independent firms, like Evergreen.

"Within a wirehouse, our ability to brand ourselves and serve our clients as fiduciaries was restricted,"

- Former Merrill Lynch Advisor, Ash Chopra

"Now we can say we're a 100% employee owned, 100% fiduciary firm. Wells Fargo is a very good firm, but it's not a 100% fiduciary firm."

- Former Wells Fargo Advisor, Tom Moran

I started by giving a silly analogy about a doctor not behaving in his or her client's best interest. In the world of finance, this analogy plays out in very real ways. Consider some of the following distinctions between an advisor at a firm like Evergreen's (fiduciary) versus an advisor at a big bank/broker-dealer (suitability).

Fees

Suitability/Brokerage firm: A financial advisor at a bank is allowed to receive compensation from both fees AND commissions. "Fees" are a percentage of assets they manage. If those assets appreciate, so do the fees. If the assets decline, so do the fees, which seems to align the client outcome with that of the advisor. However, commissions work differently, as an advisor is paid irrespective of how an investment performs. Commissions are paid to an advisor for placing a client into an investment, leaving what would appear to be a dangerous conflict of interest. [2]

Fiduciary/RIA: a Registered Investment Advisor also charges a fee but is prohibited from collecting any form of commission. It's cut and dry for firms like Evergreen: give good advice, grow client assets, and make more money. There are no other levers we can pull or products we can sell to boost revenue.

---

[1] Registration with the SEC does not imply any certain level of skill or training.

Transparency

Suitability/Brokerage firm: If you ask an advisor at a big bank questions about the specifics of their practice within their parent bank (i.e. the size of their practice number of clients, investment professionals dedicated to our accounts, average client size, ownership structure, etc.), the honesty of the answers you receive are at the mercy of their integrity since there's no way to verify them. They are not required to break down their "practice" because the bank reports for the company as a whole. In other words, you may be able to look up how much money Morgan Stanley Advisors run across the entire company, but there is no way for you determine the characteristics of "The John Smith Group" within Morgan Stanley.

Fiduciary/RIA: You don't need to ask questions or rely on integrity with a Fiduciary/RIA. Instead, for all firms like Evergreen, you can go and lookup what's called a FORM ADV on the SEC's website. The form is basically an x-ray of the firm and provides relevant information for a client's due diligence process.

Conflict of Interests

Suitability/Brokerage firm: Often times these banks create partnerships with investment providers who offer mutual funds, insurance products, private investments, structured products, etc. Advisors can earn commission for referring a client to one of these. Consider, the following simple example: a client walks into a brokerage house and says, "I want to invest $1 million into the stock market." The advisor now has to begin balancing their own self-interest and the client's. Certain stock mutual funds pay juicy commissions, while other stocks strategies offer far less compensation for the advisor. Which do they choose if both are "suitable" the client? I'll let you guess.

Fiduciary/RIA: The same client walks into a firm like Evergreen and asks to invest $1 million into the stock market. First, we should remember that we are held to a higher standard which states that whatever we recommend must be "in the best interest of the client." Second, our outcomes are aligned due to the fact we charge fees not commissions. We want the assets to grow so our fees grow alongside the client's account. Most investors probably find these two points very comforting, as they should.

---

[2]

Suitability/Brokerage firm: Another topic I hear advisors at big banks tout is their access to Initial Public Offerings (IPOs.) Due to their investment banking division, brokerage houses often get allocated a portion of the latest and greatest IPOs. (As an aside, I'm always stunned by the infatuation investors have with IPOs. Did you know that 3-years after launch 64% of all IPOs do worse than the overall market?) What is often overlooked by clients is the limited IPO shares that the bank has to offer. If a big bank is in a position where more clients want shares than are available, the bank must decide how to divvy them up. Some banks may employ a lottery type system, while others allocate them based on the value of the client. Oh, I forgot to mention that advisors typically get paid a commission for placing clients into these IPOs, with the largest commissions being attached to the least beloved IPOs.

Fiduciary/RIA: Because we are not a bank (broker-dealer), firms like Evergreen do not get allocated shares of an IPO. If we buy them, it is in what's known as a secondary market, which means after they begin trading on the stock market. Further, our only motivation for buying them is if we deem them to be good investments, as we can't collect commissions.

Suitability/Brokerage firm: Big banks have a range of different divisions: mortgage, investment banking, commercial banking, private banking, and alternatives are some of the more common ones. Each is a profit center for the bank. Getting a bank client to utilize as many of their products means more profit. Banks know this and encourage advisors to cross-sell their products to further entrench clients. The more services they utilize, the harder it is for clients to leave. Guess what? It works very well. We've had countless clients who want to transfer their investments to Evergreen but expressed reservations because of certain discounts they receive from the bank for the investment of their personal assets. As we point out to clients, keeping your life savings somewhere to save a little on your loans may not be the prudent choice.

Fiduciary/IRA: Since Evergreen and other RIAs are not banks, we cannot cross-sell banking services. Frequently, advisors from other banks are interested in going to an independent firm like Evergreen. In many cases, what stops these advisors from taking the leap is how much of their compensation they'd have to leave behind. The portion of their income that is derived from commission products cannot follow them to a firm like Evergreen.

Flashback

There was a time where my primary function at Evergreen was to "pitch" prospective clients. It was fun because no two meetings were ever the same. The closest analogy I could offer would be that of performing "improv." You went into a meeting with a template and set of talking points, but rarely did it stay on script. Some prospects would fire questions in an attempt to test your knowledge, but there was a problem with this approach. In most circumstances, hopefully, the interviewer (client) knew less about the subject matter than the interviewee (advisor.) Some people took a different approach, they'd largely skip technical market related questions in favor of trying to determine if they could trust you. I find this problematic as well. Determining if someone is trustworthy enough to manage your money is tough to determine over the course of a meeting or two. I would often tell clients to consider common sense things they could confirm. These were things like number of clients, assets managed, employees at the firm, firm ownership, how the advisor makes money. As it turns out, when you're interviewing a firm like Evergreen, these are things you can factually validate. When interviewing an advisor at a big bank, you cannot. Selecting an advisor is not an easy task. In a world that's laden with financial jargon, complicated strategies, and lacks transparency, most people find the process to be uneasy.

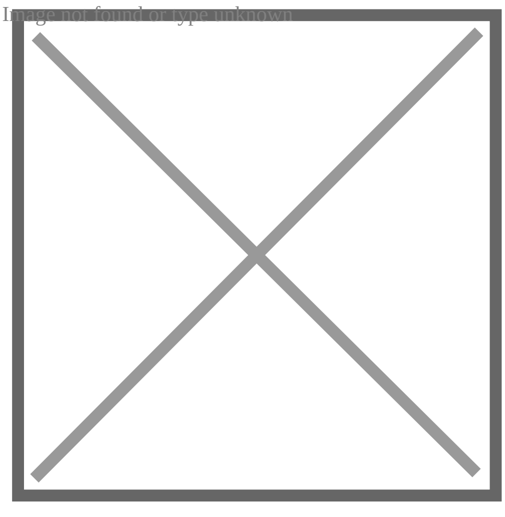
Summary

I don't think all investment advisors at big banks are malicious and simply view their clients as prey. Surely, some of them act with integrity because they care about their clients and doing what's right for them. All products offered by a bank are not bad and some play a necessary role in a client's financial playbook. That being said, I think it's very difficult for the average client to know if they are being sold the best product, given the amount of conflicts that exist.

To be clear, I'm not saying that every client at a big bank is getting deceived, but it's very hard for the client to know. Further, I'm hardly saying something profound here, as the statistics have shown a steady exodus as advisors migrate from Suitability/Brokerage firms to Fiduciary/RIA firms. However, in many cases, the rate of departure has been slower than many in the industry predicted, due to the way clients and advisors are embedded with banks.

I'll finish by asking you to choose between two doctors. Doctor A must adhere to medical standards that he/she concludes to be purely in the patient's best interest. Doctor B also has medical standards to consider, but they are looser. They can prescribe something that benefits themselves as long as it's "suitable" for the patient. I don't know any individuals who would trust their life to Doctor B, yet I know far too many people who have invested their life savings with Advisor B.

[Explore Our Private Wealth Page]



Tyler Hay
Chief Executive Officer

DISCLOSURE: This material has been prepared or is distributed solely for informational purposes only and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Any opinions, recommendations, and assumptions included in this presentation are based upon current market conditions, reflect our judgment as of the date of this presentation, and are subject to change. Past performance is no guarantee of future results. All investments involve risk including the loss of principal. All material presented is compiled from sources believed to be reliable, but accuracy cannot be guaranteed and Evergreen makes no representation as to its accuracy or completeness. Securities highlighted or discussed in this communication are mentioned for illustrative purposes only and are not a recommendation for these securities. Evergreen actively manages client portfolios and securities discussed in this communication may or may not be held in such portfolios at any given time.