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2005 Climate Control

What does next year hold for the financial services industry?

By Sheryl Nance-Nash

2005 will be anything but dull in the financial services industry. Few things that are financial will be spared scrutiny.

While the first half of this year was promising, with rays of hope about economic recovery, by summer, uncertainty was in the air—about higher interest rates, the unstable stock market, terrorism on American soil, and the upcoming presidential election. Consumer confidence about current conditions was mixed, but favorable overall—cautiously optimistic, according to the Conference Board's Consumer Confidence Index for July.

There's optimism, too, about the financial services industry. "I believe that from Wall Street's perspective, next year will be very healthy for the financial services industry. These firms have cut expenses and have been hoarding cash. 2005 may, in fact, be a boom year," predicts David Lee, CEO of Client Dynamics, a provider of client management software based in Irvine, Calif.

The truth is, there are so many variations, permutations and possibilities, that an industry outlook is sheer guesswork. That said, there are some telltale signs that likely will put increased regulation, continued consolidation, competition for talent and customer service at the top of the list of issues that define 2005.

Wave of regulation 2005? Well, just call it "Ethics, Part 2." "We've seen the first wave of change in ethics to hit senior management, which now has to attest and sign to the veracity of documents," says Larry Barton, president and CEO of The American College in Bryn Mawr, Penn., which specializes in financial services education. "What's coming down the pike next is ethics becoming a priority for the next level of management—the senior b-team, like the person next in line to be treasurer. People at that level need to know what's required under Sarbanes-Oxley. The accounting community will need to offer more training and development to the people the next level down."

This is challenging from not only a practical standpoint, but a philosophical one, as well. "While in some instances ethics have risen to new, elevated levels, it's not true in all cases. Some companies are still more concerned with conforming to the law, versus doing right for the right reason, because it's right. Such thinking isn't in the belly yet," says Barton.

"We are likely to see increased regulations and government oversight in many financial areas next year that broadly affect retirement plans, annuities, mutual funds, hedge funds and variable annuities," says Scott Coleman, co-founder of KRD Financial, LLC in Schaumburg, Ill. and current board member of the Greater Chicago Chapter of the Society of Financial Service Professionals.

"If passed, much of the proposed legislation will affect advisers in significant ways," he says. "One example is legislation that would do away with 12b-1 fees, a revenue source that, if eliminated, potentially could lead to higher front-end brokerage commissions and revised compensation structures for investment advisers."

Coleman also anticipates that hedge funds, which are now largely unregulated, will be obligated to provide greater financial disclosure to investors. In mid-July, the Securities and Exchange Commission (SEC) voted to publish the proposed new Rule 203(b)(3)-2 for comment. The rule would require hedge fund advisers to register with the Commission under the Investment Advisers Act of 1940. The Commission also voted to propose related rule amendments.

Registration under the new rule would permit the SEC to, among other things: collect and provide to the public basic information about hedge funds and hedge fund advisers, including the number of hedge funds operating in the United States, the amount of assets, and the identity of their advisers; examine hedge fund advisers to identify compliance problems early on and deter questionable practices; and improve disclosures made to prospective and current hedge fund investors.

Some experts suspect, too, that regulatory fever in 2005 will reach sectors like nonprofits and government agencies. "More than 25 percent of the economy is nonprofit and government jobs, yet they haven't received scrutiny in terms of their accounting practices. That's likely to change," says Barton.

CPAs feel the pressure "Next year is likely to be more stressful for those in the financial industry, especially CPAs. The environment will be more complex, and yet they will have less time to deal with the complexities—and will need to deal with them with fewer resources and greater penalties for mistakes," explains Chris Curtis, CPA, VP at Ashton Partners, a Chicago-based strategic advisory firm.

Accelerated filings deadlines already have surfaced, and the timeframe is scheduled for further reduction next year. Meanwhile, there are additional rules that need to be followed and less staff to help ensure processes remain smooth and seamless, Curtis explains. As a result, a recent report in the *Wall Street Journal* states that securities regulators may allow public companies a one-year extension in order to comply with rules intended to speed up annual report filings.

As of December, most companies should begin filing annual reports with the SEC within 60 days of their year-end—that's some 15 days earlier than current practice. In the meantime, the much talked of Section 404 of Sarbanes-Oxley will make it a major feat to meet the accelerated filing schedule. Companies are

scrambling to get their internal controls in order, and to have them tested and signed off on by independent, outside auditors—and all in time for the results to be published in the annual report. Companies are concerned that they won't be able to pull all this off.

Such changes practically guarantee the midnight oils will be burning in 2005. "The internal control certification of the financial reporting process presents a challenge not only for the company, but also for the CPA firm that must issue an internal control report," says Richard Soukup, CPA, partner in Assurance—Financial Institutions, for Grant Thornton LLP in Chicago. Add expanded corporate governance to the mix, and it's sure to be an interesting year.

Soukup says CPAs have to work more diligently with audit committees to tackle the laundry list of dos and don'ts that must be followed given the new rules and regulations. "The process is more intense and formal than before. There are a lot more meetings with the audit committee, and that committee has gotten more sophisticated in nature. It's a good thing, but it's new, and anything new is usually challenging," he explains.

Scouting for talent It would seem that pressures and responsibilities are due to increase just at a time when talent is in short supply. What's a company to do?

McGladrey & Pullen LLP wants to add more than 500 professionals to handle the anticipated growth in revenues that it seeks, says Daniel Trigg, partner, National Financial Services Practice Leader in McGladrey's Schaumburg, Ill. office. "In the world of Sarbanes-Oxley, there is a need for specialized knowledge that comes from experienced professions," says Trigg. "Although our revenue growth is good, our growth potential is limited by not having a deeper talent pool."

The firm is coping by revising its recruiting strategies from a local office college-recruiting effort to a more structured national college-recruiting effort, and has put an executive search firm on retainer to help it find candidates. Also, current employees are rewarded for identifying and recruiting experienced staff.

According to Trigg, McGladrey is far from alone in its worker crunch. Most public accounting firms are struggling to find experienced staff, he says. "We're in a significant quandary. Do we hire more college graduates and educate them on the financial services industry if we can't find the experienced people at the levels we want? If so, that presents a whole set of other issues, like education, professional development, mentoring, etc.," he explains.

It will be a challenge to determine just the right way to remedy the worker shortage. And that challenge pretty much ensures a continued emphasis on identifying, training and retaining talent—and planning for the successors of tomorrow.

It's all about the client Client relations is another focus that's likely to intensify over the coming year. With no shortage of players in the financial services arena, the competition is now beyond fierce. Getting and keeping clients is an art form to be mastered.

If you want confirmation of the client-centered trend, look at the slogans of firms like Merrill Lynch. Its "Total Merrill" concept asks, "How do you see your financial life? Your investments are here. Your retirement there. Your mortgage over here. You're banking way over there. Seen separately and managed

separately, your financial life can only take you so far. Now there's a way to go beyond those limits. At Merrill Lynch, we see your financial life in total."

Translation: We want all of your business.

UBS' global advertising campaign, "You and Us," is another prime example. The campaign highlights the intimate approach UBS takes to its client relationships. Then there's Morgan Stanley's "One client at a time." Do you see a pattern?

Increasingly, too, clients want one-stop shopping. "The world is more complex. People, especially Baby Boomers, have inherited wealth and have done well themselves so they might own a business, trusts and retirement vehicles, and they don't want five advisers to handle their affairs. They want someone to coordinate, and they're willing to pay for it," says Bruce Fenton, president of Atlantic Financial Inc., an independent investment firm based in Westboro, Mass.

So the onus is on CPAs to grab a share of that business, particularly that of high net-worth individuals. "Be ready to offer the services they are looking for. If you don't understand hedge funds, you're doing a disservice to your clients if you have some for whom those funds would be appropriate as investments. You may find that you or others in your firm need more specialized training. The landscape is so competitive that you have to be prepared to compete. Firms are doing everything from offering bill paying to concierge services as incentives to clients," says Fenton.

There are ways for CPA firms to meet the demand for greater client focus, explains John Passananti, a financial adviser with AXA Advisors in Oak Brook, Ill. "They can hire a financial planner to work in house, acquire a financial planning firm, or form a strategic alliance/partnership with a firm that has the expertise." While currently there are a small number of CPA firms providing financial services to their clients, he anticipates that nearly half of all CPA firms will be providing such services in the next few years.

Simply put, firms will have to join forces or cease to exist. And although there's an obvious upside to a strategic alliance that can improve the bottom line, such relationships cannot be taken lightly. Your firm's reputation and client relationships are at stake.

"There's a time commitment to ensure the success of the partnership. You have to invest the time to make sure you have the right partner. You don't want to put your client in front of someone that doesn't have the right capabilities, staff, expertise or culture," explains Passananti. "You have to manage the relationship with your partner and then you have to market your new capabilities. It's an involved process, but it can pay off."

In 2005 and beyond, financial services will be about much more than numbers. Says Barton: "Clients want us to drive the discussion about fundamental issues of performance, how is their organization performing, what sort of expense controls are necessary, is the organization using their people efficiently, for example. Whether the client is corporate or an individual, you must demonstrate value-added benefits."

All in all, life for the financial services industry in 2005 will be marked by change and the expected pressure that accompanies change. However, if you're prepared for it, next year also could be a time of improved service to clients and increased profitability for businesses. □

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